NZ ACCOUNTING STANDARDS BOARD

Board Meeting Agenda

Thursday 3 May 2018
External Reporting Board, Level 7, 50 Manners Street, Wellington

Est Time	Item	Topic	Objective		Page
B: PUBLIC SESSION					
PBE Item for Consideration					
12.30 pm	**6**	**IPSASB ED 64 *Leases***	(VSF)		
	6.1	Cover Memo	Note	Paper	
	6.2	Memo – Concessionary Leases	Consider	Paper	
	6.3	Draft Comment Letter	Consider	Paper	
	6.4	ED 64 Leases	Note	Supp paper	
	6.5	ED 64 At A Glance	Note	Supp paper	
PBE Item for Approval					
2.00 pm	**7**	**IPSASB Strategy and Work Plan Consultation**	(ALH)		
	7.1	Cover Memo	Note	Paper	
	7.2	Draft Comment Letter	Consider	Paper	
	7.3	IPSASB Proposed Strategy and Work Plan 2019–2023	Note	Supp paper	
	7.4	Appendix B: Analysis of Potential Projects Against Selection Criteria	Note	Supp paper	
For-profit Item for Approval					
2.40 pm	**8**	**Conceptual Framework**	(JS)		
	8.1	Cover Memo	Consider	Paper	
	8.2	Memo New Zealand-specific Amendments	Consider	Paper	
	8.3	NZ Conceptual Framework	Approve	Paper	
	8.4	Amendments to References to the Conceptual Framework	Approve	Paper	
	8.5	Draft Signing Memorandum	Approve	Paper	
	8.6	IFRS Conceptual Framework: Project Summary	Note	Supp paper	
	8.7	IFRS Conceptual Framework: Feedback Statement	Note	Supp paper	
	8.8	NZASB Comment Letter (2015)	Note	Supp paper	
3.00 pm		*Afternoon tea*			
3.15 pm	**8**	**Conceptual Framework (contd)**			

Est Time	Item	Topic	Objective		Page
For-profit Standard for Approval					
3.35 pm	**9**	**Amendments to the Scope of FRS-42**	(TC)		
	9.1	Cover Memo	Consider	Paper	
	9.2	Amendments to the Scope of FRS-42	Approve	Paper	
	9.3	Draft Signing Memorandum	Approve	Paper	
	9.4	Submissions Received			
	9.4.1	Submission from BDO New Zealand	Note	Paper	
	9.4.2	Submission from Financial Markets Authority	Note	Paper	
Standard for Noting					
4.04 pm	**10**	**Standard Approved**	(VSF)		
	10.1	Approval 96 *Plan Amendment, Curtailment or Settlement* (Amendments to NZ IAS 19)	Note	Paper	

Next NZASB meeting: Wednesday 27 June 2018

Accounting Policy Changes

(Proposed amendments to IAS 8)

Comments to be received by 27 July 2018

Exposure Draft ED/2018/1 *Accounting Policy Changes* (Proposed amendments to IAS 8) is published by the International Accounting Standards Board (Board) for comment only. The proposals may be modified in the light of comments received before being issued in final form. Comments need to be received by 27 July 2018 and should be submitted in writing to the address below, by email to commentletters@ifrs.org or electronically using our 'Open for comment' page at: http://go.ifrs.org/open-for-comment.

All comments will be on the public record and posted on our website at www.ifrs.org unless the respondent requests confidentiality. Such requests will not normally be granted unless supported by good reason, for example, commercial confidence. Please see our website for details on this and how we use your personal data.

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Introduction

In this Exposure Draft, the International Accounting Standards Board (Board) proposes to amend IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The Board expects these amendments to facilitate the application of particular voluntary changes in accounting policy, improving the overall quality of financial reporting.

Background

Applying IAS 8, an entity changes an accounting policy only if the change is required by an IFRS Standard or results in improving the usefulness of information provided to users of its financial statements. A common reason why an entity voluntarily changes an accounting policy is to reflect explanatory material included in agenda decisions published by the IFRS Interpretations Committee (agenda decisions). The objective of including explanatory material in agenda decisions is to facilitate greater consistency in the application of IFRS Standards. An agenda decision is non-authoritative and, therefore, any resulting change is not required by IFRS Standards.

Applying a voluntary change in accounting policy that results from an agenda decision can be challenging in some situations. This is because IAS 8 requires an entity to apply a voluntary change in accounting policy retrospectively as if it had always applied the new policy, except to the extent it is impracticable to do so.

To facilitate voluntary changes in accounting policy that result from an agenda decision, the Board proposes amending IAS 8 to lower the impracticability threshold for retrospective application of such changes. The proposed threshold would include consideration of the expected benefits to users of financial statements of applying the new accounting policy retrospectively and the cost to the entity of determining the effects of retrospective application.

Invitation to comment

The Board invites comments on Exposure Draft *Accounting Policy Changes* (Proposed amendments to IAS 8), particularly on the questions set out below. Comments are most helpful if they:

(a) address the questions as stated;

(b) indicate the specific paragraph(s) to which they relate;

(c) contain a clear rationale;

(d) identify any wording in the proposals that is difficult to translate; and

(e) include any alternative the Board should consider, if applicable.

The Board is requesting comments only on matters addressed in this Exposure Draft.

Questions for respondents

Question 1
The Board proposes to amend IAS 8 to introduce a new threshold for voluntary changes in accounting policy that result from an agenda decision published by the IFRS Interpretations Committee. The proposed threshold would include consideration of the expected benefits to users of financial statements from applying the new accounting policy retrospectively and the cost to the entity of determining the effects of retrospective application. Do you agree with the proposed amendments? Why or why not? If not, is there any particular aspect of the proposed amendments you do or do not agree with? Please also explain any alternatives you would propose, and why.

Question 2
The Board decided not to amend IAS 8 to address the timing of applying a change in accounting policy that results from an agenda decision published by the IFRS Interpretations Committee. Paragraphs BC18–BC22 of the Basis for Conclusions on the proposed amendments set out the Board's considerations in this respect. Do you think the explanation provided in paragraphs BC18–BC22 will help an entity apply a change in accounting policy that results from an agenda decision? Why or why not? If not, what do you propose, and why? Would you propose either of the alternatives considered by the Board as outlined in paragraph BC20? Why or why not?

Deadline

All comments must be received on or before 27 July 2018.

How to comment

We would prefer to receive your comments electronically; however, comments can be submitted using any of the following methods:

Electronically	Visit the 'Open for comment' page at: http://go.ifrs.org/open-for-comment
By email	Email comments can be sent to: commentletters@ifrs.org
By post	IFRS Foundation 30 Cannon Street London EC4M 6XH United Kingdom

All comments will be on the public record and posted on our website unless confidentiality is requested. Such requests will not normally be granted unless supported by good reason, for example, commercial confidence. Please see our website for details on this and on how we use your personal data.

[Draft] Amendments to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

Paragraphs 5, 23, 24, 25, 26, 27, 28, 29 and 47 are amended and paragraphs 25A, 25B, 27A and 54G are added. The heading above paragraph 54 is amended. New text is underlined and deleted text is struck through. Paragraphs 19 and 22 have not been amended but are included for ease of reference.

Appendix A and paragraphs A1 and A6–A10 have been added. These paragraphs have not been underlined for ease of readability. Paragraphs 50–53 are deleted. The requirements in paragraphs 50–53 are not deleted but have been moved, without amendment, to paragraphs A2–A5.

Definitions

...

5 **...**

<u>An *agenda decision* is a decision published by the IFRS Interpretations Committee explaining its rationale for not adding a particular matter to its standard-setting agenda.</u>

<u>An agenda decision may result in a voluntary change in accounting policy, a change in accounting estimate or the correction of a prior period error. An entity shall apply the requirements of this Standard to determine the nature of, and the required accounting for, any change that results from an agenda decision.</u>

...

Accounting policies

...

Applying changes in accounting policies

19 **Subject to paragraph 23:**

(a) an entity shall account for a change in accounting policy resulting from the initial application of an IFRS in accordance with the specific transitional provisions, if any, in that IFRS; and

(b) when an entity changes an accounting policy upon initial application of an IFRS that does not include specific transitional provisions applying to that change, or changes an accounting policy voluntarily, it shall apply the change retrospectively.

...

Retrospective application

22 **Subject to paragraph 23, when a change in accounting policy is applied retrospectively in accordance with paragraph 19(a) or (b), the entity shall adjust the opening balance of each affected component of equity for the**

earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.

Limitations on retrospective application

23 **When retrospective application is required by paragraph 19(a) or (b), an entity shall apply a change in accounting policy ~~shall be applied~~ retrospectively except:**

(a) to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the change; or

(b) if the change in accounting policy results from an agenda decision, to the extent that the cost to the entity of determining either the period-specific effects or the cumulative effect of the change exceeds the expected benefits to users. Paragraphs A6–A10 provide guidance on assessing the expected benefits and cost.

24 **When it is impracticable to determine the period-specific effects of changing an accounting policy on comparative information for one or more prior periods presented, the entity shall:**

(a) apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period~~,~~; and

(b) ~~shall~~ make a corresponding adjustment to the opening balance of each affected component of equity for that period.

25 **When it is impracticable to determine ~~the cumulative effect~~, at the beginning of the current period, the cumulative effect of applying a new accounting policy to all prior periods, the entity shall adjust the comparative information to apply the new accounting policy prospectively from the earliest date practicable.**

25A **Applying paragraph 23(b), the cost to the entity of determining the period-specific effects on comparative information for one or more prior periods presented might be determined to exceed the expected benefits to users of applying the change retrospectively. In this situation, the entity shall:**

(a) apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which the expected benefits to users of applying the change retrospectively exceed the cost to the entity of determining the effects of the change; and

(b) make a corresponding adjustment to the opening balance of each affected component of equity for that period.

25B **Applying paragraph 23(b), the cost to the entity of determining, at the beginning of the current period, the cumulative effect of applying a new accounting policy to all prior periods might be determined to exceed the**

expected benefits to users of applying the change retrospectively. In this situation, the entity shall adjust the comparative information to apply the new accounting policy prospectively from the earliest date for which the expected benefits to users of applying the change prospectively exceed the cost to the entity of determining the effects of the change.

26 When an entity applies a new accounting policy retrospectively, it applies the new accounting policy to comparative information for prior periods as far back as is practicable or, when paragraph 23(b) applies, as far back as the expected benefits to users of retrospective application exceed the cost to the entity of determining the effects of the change. Retrospective application to a prior period is not practicable unless it is practicable to determine the cumulative effect on the amounts in both the opening and closing statements of financial position for that period. Similarly, when paragraph 23(b) applies, the expected benefits to users of retrospective application to a prior period exceed the cost to the entity of determining the cumulative effect of the change only if those benefits exceed the cost of determining the cumulative effect on the amounts in both the opening and closing statements of financial position for that period. The amount of the resulting adjustment relating to periods before those presented in the financial statements is made to the opening balance of each affected component of equity of the earliest prior period presented. Usually the adjustment is made to retained earnings. However, the adjustment may be made to another component of equity (for example, to comply with an IFRS). Any other information about prior periods, such as historical summaries of financial data, is also adjusted as far back as is practicable or, when paragraph 23(b) applies, as far back as the expected benefits to users exceed the cost to the entity of making those adjustments.

27 When it is impracticable for an entity to apply a new accounting policy retrospectively, because it cannot determine the cumulative effect of applying the policy to all prior periods, the entity, in accordance with paragraph 25, applies the new policy prospectively from the start of the earliest period practicable. It therefore disregards the portion of the cumulative adjustment to assets, liabilities and equity arising before that date. Changing an accounting policy is permitted even if it is impracticable to apply the policy prospectively for any prior period. Paragraphs ~~50–53~~ A2–A5 provide guidance on when it is impracticable to apply a new accounting policy to one or more prior periods.

27A When applying paragraph 25B, an entity disregards the portion of the cumulative adjustment to assets, liabilities and equity arising before the earliest date for which the expected benefits to users of applying the change prospectively exceed the cost to the entity of determining the effects of the change. Changing an accounting policy is permitted even if the expected benefits to users do not exceed the cost to the entity of determining the effect of applying the policy prospectively for any prior period.

Disclosure

28 When an entity changes an accounting policy upon initial application of an IFRS ~~has an effect on the current period or any prior period, would~~

~~have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an,~~ the entity shall disclose:

...

29 When ~~a voluntary change in~~ an entity changes an accounting policy voluntarily ~~has an effect on the current period or any prior period, would have an effect on that period except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an~~, the entity shall disclose:

(a) the nature of the change in accounting policy;

(b) the reasons why applying the new accounting policy provides reliable and more relevant information;

(c) for the current period and each prior period presented, to the extent practicable or, if paragraph 23(b) applies, to the extent the expected benefits to users exceed the cost to the entity, the amount of the adjustment:

(i) for each financial statement line item affected; and

(ii) if IAS 33 applies to the entity, for basic and diluted earnings per share;

(d) the amount of the adjustment relating to periods before those presented, to the extent practicable or, if paragraph 23(b) applies, to the extent the expected benefits to users exceed the cost to the entity; and

(e) if retrospective application is impracticable or, if paragraph 23(b) applies, to the extent the cost to the entity exceeds the expected benefits to users for a particular prior period, or for periods before those presented, the circumstances that led to ~~the existence of that condition~~ either the impracticability or the cost to the entity exceeding the expected benefits to users, and a description of how and from when the change in accounting policy has been applied.

...

Errors

...

Limitations on retrospective restatement

...

47 When it is impracticable to determine the amount of an error (eg a mistake in applying an accounting policy) for all prior periods, the entity, in accordance with paragraph 45, restates the comparative information prospectively from the earliest date practicable. It therefore disregards the portion of the cumulative

restatement of assets, liabilities and equity arising before that date. Paragraphs ~~50–53~~ A2–A5 provide guidance on when it is impracticable to correct an error for one or more prior periods.

...

~~Impracticability in respect of retrospective application and retrospective restatement~~[1]

50 [Deleted] ~~In some circumstances, it is impracticable to adjust comparative information for one or more prior periods to achieve comparability with the current period. For example, data may not have been collected in the prior period(s) in a way that allows either retrospective application of a new accounting policy (including, for the purpose of paragraphs 51–53, its prospective application to prior periods) or retrospective restatement to correct a prior period error, and it may be impracticable to recreate the information.~~

51 [Deleted] ~~It is frequently necessary to make estimates in applying an accounting policy to elements of financial statements recognised or disclosed in respect of transactions, other events or conditions. Estimation is inherently subjective, and estimates may be developed after the reporting period. Developing estimates is potentially more difficult when retrospectively applying an accounting policy or making a retrospective restatement to correct a prior period error, because of the longer period of time that might have passed since the affected transaction, other event or condition occurred. However, the objective of estimates related to prior periods remains the same as for estimates made in the current period, namely, for the estimate to reflect the circumstances that existed when the transaction, other event or condition occurred.~~

52 [Deleted] ~~Therefore, retrospectively applying a new accounting policy or correcting a prior period error requires distinguishing information that~~

~~(a) provides evidence of circumstances that existed on the date(s) as at which the transaction, other event or condition occurred, and~~

~~(b) would have been available when the financial statements for that prior period were authorised for issue~~

~~from other information. For some types of estimates (eg a fair value measurement that uses significant unobservable inputs), it is impracticable to distinguish these types of information. When retrospective application or retrospective restatement would require making a significant estimate for which it is impossible to distinguish these two types of information, it is impracticable to apply the new accounting policy or correct the prior period error retrospectively.~~

53 [Deleted] ~~Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been in a prior period or~~

1 Paragraphs 50–53 are deleted. The requirements in paragraphs 50–53 are not deleted but have been moved, without amendment, to paragraphs A2–A5.

~~estimating the amounts recognised, measured or disclosed in a prior period. For example, when an entity corrects a prior period error in calculating its liability for employees' accumulated sick leave in accordance with IAS 19 *Employee Benefits*, it disregards information about an unusually severe influenza season during the next period that became available after the financial statements for the prior period were authorised for issue. The fact that significant estimates are frequently required when amending comparative information presented for prior periods does not prevent reliable adjustment or correction of the comparative information.~~

Transition and ~~Effective~~ effective date

...

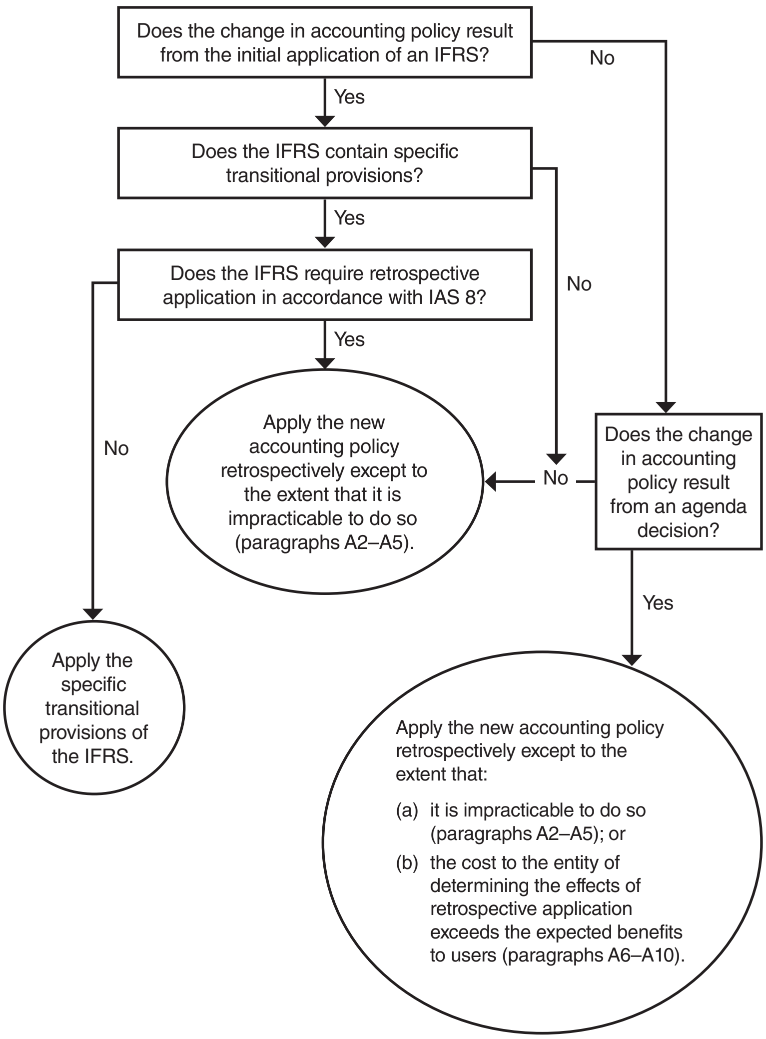
54G *[Draft] Accounting Policy Changes* (Amendments to IAS 8) issued in [date] amended paragraphs 5, 23, 24, 25, 26, 27, 28, 29 and 47; added paragraphs 25A, 25B, 27A and 54G; added Appendix A and paragraphs A1–A10 and deleted paragraphs 50–53. An entity shall apply the amendments to changes in accounting policy on or after [date to be decided after exposure].

Appendix A
Application guidance

This appendix is an integral part of the Standard and has the same authority as the other parts of the Standard.

Applying changes in accounting policy (paragraphs 14–27A)

A1 The following flow chart may assist an entity in applying a change in accounting policy:



Impracticability in respect of retrospective application and retrospective restatement[2]

A2 In some circumstances, it is impracticable to adjust comparative information for one or more prior periods to achieve comparability with the current period. For example, data may not have been collected in the prior period(s) in a way that allows either retrospective application of a new accounting policy (including, for the purpose of paragraphs A3–A5, its prospective application to prior periods) or retrospective restatement to correct a prior period error, and it may be impracticable to recreate the information.

A3 It is frequently necessary to make estimates in applying an accounting policy to elements of financial statements recognised or disclosed in respect of transactions, other events or conditions. Estimation is inherently subjective, and estimates may be developed after the reporting period. Developing estimates is potentially more difficult when retrospectively applying an accounting policy or making a retrospective restatement to correct a prior period error, because of the longer period of time that might have passed since the affected transaction, other event or condition occurred. However, the objective of estimates related to prior periods remains the same as for estimates made in the current period, namely, for the estimate to reflect the circumstances that existed when the transaction, other event or condition occurred.

A4 Therefore, retrospectively applying a new accounting policy or correcting a prior period error requires distinguishing information that

(a) provides evidence of circumstances that existed on the date(s) as at which the transaction, other event or condition occurred, and

(b) would have been available when the financial statements for that prior period were authorised for issue

from other information. For some types of estimates (eg a fair value measurement that uses significant unobservable inputs), it is impracticable to distinguish these types of information. When retrospective application or retrospective restatement would require making a significant estimate for which it is impossible to distinguish these two types of information, it is impracticable to apply the new accounting policy or correct the prior period error retrospectively.

A5 Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period. For example, when an entity corrects a prior period error in calculating its liability for employees' accumulated sick leave in accordance with IAS 19 *Employee Benefits,* it disregards information about an unusually severe influenza season during the next period that became available after the financial statements for the prior

2 Paragraphs 50–53 are deleted. The requirements in paragraphs 50–53 are not deleted but have been moved, without amendment, to paragraphs A2–A5.

period were authorised for issue. The fact that significant estimates are frequently required when amending comparative information presented for prior periods does not prevent reliable adjustment or correction of the comparative information.

Expected benefits and cost of retrospectively applying a voluntary change in accounting policy that results from an agenda decision

A6 For a voluntary change in accounting policy that results from an agenda decision, an entity applies the new accounting policy to comparative information from the earliest date practicable, or, when paragraph 23(b) applies, from the earliest date for which the expected benefits to users exceed the cost to the entity of determining the effects of the change.

A7 An entity applies judgement when assessing whether the expected benefits to users exceed the cost to the entity of determining the effects of the change. An entity makes this assessment by considering all relevant facts and circumstances (see paragraphs A8–A10).

Expected benefits to users

A8 Assessing the expected benefits to users is an entity-specific consideration. When assessing the expected benefits to users of its financial statements, an entity considers how the absence of information that would be provided by applying a new accounting policy retrospectively could affect the decisions users make on the basis of the entity's financial statements. Examples of factors to consider include, but are not limited to:

(a) the nature of the change—the more significant the effect of the change in accounting policy because of its nature, the greater the likelihood that a user's decision-making could be affected by an entity not applying the change retrospectively. For example:

(i) users are likely to benefit more from retrospective application of a new accounting policy that would result in the initial recognition or derecognition of an asset or liability. Users are likely to benefit less from retrospective application of a new accounting policy that would affect only one aspect of a particular cost-based measurement of an asset or liability.

(ii) users are likely to benefit more from retrospective application of a new accounting policy that affects transactions reported in the financial statements over several periods.

(b) the magnitude of the change—the more significant the effect of the change in accounting policy relative to an entity's financial position, financial performance or reporting of cash flows, the greater the likelihood that a user's decision-making could be affected by the entity not applying the change retrospectively. For example, users are likely to benefit more from retrospective application of a new accounting policy that would result in a large increase in an entity's liabilities than from one that would result only in a small increase in the entity's liabilities.

(c) the pervasiveness of the change across the financial statements—the more pervasive the effect of the change in accounting policy across an entity's financial statements, the greater the likelihood that a user's decision-making could be affected by an entity not applying the change retrospectively. For example, users are likely to benefit more from retrospective application of a new accounting policy that would result in consolidating a subsidiary the entity had not previously consolidated because this could affect the statements of financial position, profit or loss and other comprehensive income, and cash flows. Users are likely to benefit less from the retrospective application of a new accounting policy that affects only amounts reported within different components of equity.

(d) the effect of the change on trend information—the more significant the effect of the change in accounting policy on information used for trend analysis, the greater the likelihood that a user's decision-making could be affected by an entity not applying the change retrospectively. For example, users are likely to benefit more from the retrospective application of a new accounting policy that affects frequent or recurring transactions that are similar in nature. Users are likely to benefit less from the retrospective application of a new accounting policy that affects only transactions or events that happen infrequently or ad hoc.

(e) the extent of departure from retrospective application—the greater an entity's departure from retrospective application, the greater the likelihood that a user's decision-making could be affected by an entity not applying the change in accounting policy retrospectively. For example, users are likely to benefit less from an entity applying a new accounting policy prospectively (as described in paragraph 25B) than they would from the entity applying the new policy retrospectively by adjusting opening retained earnings of the current period but without restating comparative information for one or more prior periods presented (as described in paragraph 25A).

Cost to the entity of determining the effects of retrospective application

A9 When assessing the cost to the entity of determining the effects of retrospective application, an entity considers the additional cost it would reasonably expect to incur and the additional effort it would reasonably expect to make to determine the period-specific effects or the cumulative effect of the change. Additional cost is any cost an entity reasonably expects to incur to obtain the information necessary to determine the period-specific effects or the cumulative effect of the change over and above the cost already incurred. Similarly, additional effort is any effort an entity reasonably expects to make to obtain the information necessary to determine the period-specific effects or the cumulative effect of the change over and above the effort already made.

A10 In making this assessment, an entity considers, among other things:

(a) whether the information necessary to apply the new accounting policy retrospectively and/or restate prior period information is reasonably available without undue cost and effort. If an entity already has or could obtain or develop without significant additional cost and effort information necessary to apply the new accounting policy retrospectively, the expected benefits to users of retrospective application are likely to exceed the cost to the entity of determining the effects of the change.

(b) the extent of the departure from retrospective application. The greater the extent of an entity's departure from retrospective application, the greater the extent of the analysis an entity must undertake to assess whether the cost to the entity of determining the effects of retrospective application exceed the expected benefits to users of applying the change retrospectively.

For example, an entity initially assesses whether the cost to the entity of determining the period-specific effects on comparative information for one or more prior periods presented exceeds the expected benefits to users of applying the change retrospectively. In situations in which the cost exceeds the expected benefits, the entity then assesses the cost and benefits of applying the new accounting policy retrospectively but without restating comparative information (as described in paragraph 25A). The point at which no further assessment is required is the point at which the entity concludes that the expected benefits to users exceed the cost to the entity.

Approval by the Board of Exposure Draft *Accounting Policy Changes* (Proposed amendments to IAS 8) issued in March 2018

The Exposure Draft *Accounting Policy Changes* (Proposed amendments to IAS 8) was approved for issue by all 14 members of the International Accounting Standards Board.

Hans Hoogervorst	Chairman
Suzanne Lloyd	Vice-Chair
Nick Anderson	
Martin Edelmann	
Françoise Flores	
Amaro Luiz de Oliveira Gomes	
Gary Kabureck	
Jianqiao Lu	
Takatsugu Ochi	
Darrel Scott	
Thomas Scott	
Chungwoo Suh	
Ann Tarca	
Mary Tokar	

Basis for Conclusions on Exposure Draft *Accounting Policy Changes* (Proposed amendments to IAS 8)

This Basis for Conclusions accompanies, but is not part of, the proposed amendments. It summarises the considerations of the International Accounting Standards Board (Board) when developing the proposed amendments. Individual Board members gave greater weight to some factors than to others.

Background

BC1 Applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, an entity changes an accounting policy only if the change is required by an IFRS Standard or results in the financial statements providing more useful information. IAS 8 requires an entity to apply a voluntary change in accounting policy retrospectively (ie as if it had always applied the new accounting policy), except to the extent that it is impracticable to determine the effects of the change. IAS 8 sets a high threshold for impracticability—paragraph 5 states that 'applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so'. Consequently, the requirements in IAS 8 could dissuade an entity from adopting an accounting policy that would improve the usefulness of information provided to users of its financial statements.

BC2 The IFRS Interpretations Committee (Committee) discusses application questions submitted by stakeholders to assess whether any change is needed to IFRS Standards. When the Committee concludes that the principles and requirements in the Standards provide an adequate basis for an entity to determine the appropriate accounting, the Committee publishes an agenda decision[3]. In these situations, the agenda decision often includes explanatory material outlining the Committee's view on how to apply the applicable principles and requirements. All agenda decisions are subject to due process, including exposure for comment. Explanatory material in an agenda decision does not change or add to the requirements in a Standard. Paragraph 5.22 of the IFRS Foundation's *Due Process Handbook* states that agenda decisions[4] 'do not have the authority of IFRSs and they will therefore not provide mandatory requirements but they should be seen as helpful, informative and persuasive'. The Committee includes explanatory material in agenda decisions to facilitate greater consistency in the application of the Standards. Entities might therefore change, or be expected to change, an accounting policy to reflect that explanatory material. Because an agenda decision is non-authoritative, any change that results from an agenda decision is not a change that is required by IFRS Standards. Accordingly, unless it is the correction of an error, the entity accounts for that change as a voluntary change in accounting policy or a change in accounting estimate applying IAS 8 (see paragraphs BC15–BC17).

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3 There may be other reasons why the Committee publishes an agenda decision, for example when the question submitted by a stakeholder does not have widespread effect.

4 Paragraph 5.22 of the *Due Process Handbook* uses the term 'rejection notice' to describe agenda decisions.

BC3 Because an agenda decision is non-authoritative, neither the Board nor the Committee specifies transition requirements for a change in accounting policy that results from an agenda decision. This can be problematic in some situations because:

(a) the expected benefits to users of financial statements from applying a voluntary change in accounting policy retrospectively may not outweigh the cost to the entity of determining the effects of the change, even though the change might result in financial statements providing more useful information overall.

(b) explanatory material in an agenda decision might be viewed as being effective immediately upon publication, because the Committee often addresses the application of IFRS Standards that are already effective. However, entities may find it difficult to obtain the necessary information to determine the effects of retrospective application—particularly entities with interim or annual reporting dates close to the date of publication of an agenda decision.

BC4 The problems noted in paragraph BC3 might dissuade entities from making the related change in accounting policy, or from submitting questions to the Committee for consideration. In addition, the Committee might recommend undertaking standard-setting solely because of concerns about transition, rather than because of a need to change or add to the principles and requirements in IFRS Standards. Frequent changes to the Standards could be a burden to stakeholders and create unnecessary disruption.

The proposed threshold

BC5 The Board observed that one of the main causes of the problems identified in paragraph BC3 is that IAS 8 sets a high threshold—one of impracticability—for the use of anything other than retrospective application. However, when the Board or Committee develops new requirements, they consider transition and often provide entities with relief from some aspects of retrospective application—mainly for cost-benefit reasons. This same relief is not available to an entity that voluntarily changes an accounting policy. Accordingly, for a voluntary change in accounting policy that results from an agenda decision, the Board proposes lowering the impracticability threshold to one based on entity-specific cost-benefit considerations. In the Board's view, the proposed amendment could resolve some of the problems outlined in paragraph BC3, and make it easier for an entity to make voluntary changes in accounting policy that improve the usefulness of information provided to users of financial statements. The proposed amendment would also encourage greater consistency in the application of IFRS Standards in line with the Committee's objective in including explanatory material in agenda decisions.

Scope of the proposed threshold

BC6 The Board considered whether the proposed threshold should apply to all voluntary changes in accounting policy or only those that result from an agenda decision.

BC7 Some Board members suggested application of the proposed threshold to all voluntary changes in accounting policy. This is because, in their view:

(a) applying the threshold to all voluntary changes in accounting policy would make it easier for an entity to voluntarily apply any accounting policy that improves the usefulness of information provided to users of financial statements.

(b) narrowing the application of the proposed threshold only to voluntary changes in accounting policy that result from an agenda decision might:

(i) create what some would view as an arbitrary distinction between these voluntary changes and other voluntary changes in accounting policy. This is because such a distinction would make it easier for entities to apply voluntary changes in accounting policy that result from an agenda decision.

(ii) be viewed as giving authoritative status to an agenda decision.

BC8 Nonetheless, the Board proposes limiting the application of the proposed threshold to voluntary changes in accounting policy that result from an agenda decision because:

(a) the proposed threshold would apply to a smaller and known population of changes in accounting policy than if it were to apply to all voluntary changes. Applying the new threshold to a wider population might, for example, result in a loss of comparability between entities and a loss of information for users of financial statements if voluntary changes in accounting policy (other than those that result from an agenda decision) were to occur frequently.

(b) the distinction created between a voluntary change in accounting policy that results from an agenda decision and other voluntary changes would not be arbitrary given the process for developing and publishing agenda decisions[5].

(c) doing so would not change the non-authoritative status of agenda decisions; instead, it would simply identify agenda decisions as a source of voluntary changes in accounting policy.

Assessing benefits and cost

BC9 There are different ways the Board might have determined the proposed new threshold. In particular, the Board considered whether the new threshold should include consideration of only the cost to the entity of determining the effects of retrospective application or, instead, should also include consideration of the expected benefits to users of financial statements. Some Board members asked how practical it might be for entities to assess expected benefits from a user's perspective. These Board members also noted that when the Board or Committee provides relief from retrospective application of new requirements, it is the Board or Committee, not an entity itself, that assesses the expected benefits and cost.

5 The Committee first publishes a tentative agenda decision, which is open for comment for 60 days, before it considers comments and decides whether to finalise the agenda decision.

BC10 The Board proposes including consideration of the expected benefits to users of financial statements as well as the cost to an entity for the following reasons:

(a) for almost all recent IFRS Standards or amendments for which the Board did or did not provide relief from retrospective application, its main consideration was the expected benefits to users of financial statements. Accordingly, the Board decided that considering the expected benefits to users should be part of the new threshold.

(b) requiring entities to assess the expected benefits and cost would not be entirely new. Other IFRS Standards already include requirements based on benefits and cost or other similar thresholds. For example, in applying the expected credit loss impairment model, IFRS 9 *Financial Instruments* requires an entity to consider all reasonable and supportable information that is available without undue cost or effort.

(c) considering a user's perspective when making decisions about financial reporting would not be new for entities. For example, an entity considers a user's perspective when assessing materiality.

(d) the assessment of the expected benefits to users of financial statements and cost to the entity would require judgement depending on the particular facts and circumstances. However, applying judgement is an essential part of a principle-based framework—it does not, in itself, lead to inconsistent application or inappropriate accounting.

BC11 Application of the proposed threshold could result in some voluntary changes that result from an agenda decision not being applied on a fully retrospective basis, resulting in some loss of information for users of financial statements. Accordingly, the Board decided that:

(a) an entity would depart from retrospective application only to the extent that the cost of determining the effects would exceed the expected benefits to users of financial statements. An entity would apply a framework similar to that in paragraphs 23–27 of IAS 8 (with respect to the impracticability threshold) when assessing the extent to which it can depart from retrospective application.

(b) it would be important to provide a framework to support entities in applying the judgement required to assess the expected benefits to users of financial statements and the cost to the entity. Accordingly, the Board developed application guidance on expected benefits and cost. The Board has also proposed including the requirements formerly contained in paragraphs 50–53 of IAS 8 on impracticability as application guidance, without changing those requirements. This is because the nature of those requirements is similar to the requirements proposed on expected benefits and cost.

BC12 The Board has used the term 'additional' to describe the cost and effort an entity considers when assessing the cost of determining the effects of retrospective application. This is because the Board concluded that an entity should not consider cost already incurred, and effort already made, in assessing the new threshold. The focus of the assessment is on the additional cost and effort that an entity would expect to incur or make, which may differ from the total cost and effort required to obtain the information necessary to determine the effects of retrospective application.

Disclosure

BC13 Paragraph 29 of IAS 8 requires an entity to provide particular disclosures when it applies a voluntary change in accounting policy. The Board proposes to amend this paragraph to reflect the consequences of introducing the proposed threshold for a voluntary change in accounting policy that results from an agenda decision. The Board has also proposed editorial amendments to the introduction to paragraph 28 of IAS 8; these amendments do not change the requirements in that paragraph.

Transition

BC14 The Board proposes that entities apply the amendments to changes made on or after the effective date of the amendments. The Board concluded that there was no reason to either allow or require an entity to change its accounting for changes in accounting policy made before that date.

Other matters considered by the Board

Applying a change that results from an agenda decision

BC15 In proposing amendments that would apply only to a voluntary change in accounting policy that results from an agenda decision, the Board considered whether to provide guidance to help determine whether a change that results from an agenda decision is the correction of a prior period error, a voluntary change in accounting policy or a change in accounting estimate. The Board concluded that no amendment was needed because IAS 8 provides a framework to determine the nature of a change that results from an agenda decision.

BC16 Applying IAS 8, an entity first assesses whether the accounting policy previously applied meets the definition of a prior period error in paragraph 5. In some situations, the accounting previously applied could have resulted from the entity failing to use, or misusing, information that was available or could reasonably be expected to have been obtained. However, in other situations, an entity would appropriately treat a change that results from an agenda decision as either a change in accounting estimate or a voluntary change in accounting policy. The Board noted that the information in an agenda decision may provide new information that is helpful, informative and persuasive. The matters submitted to the Committee are generally complex in nature and have resulted in entities applying different reporting methods. The Committee publishes an agenda decision after research, analysis and discussion of these matters. The Committee first publishes a tentative agenda decision, and then considers comments received before finalising the agenda decision. This process often provides information that would not otherwise be available and could not otherwise reasonably be expected to have been obtained.

BC17 Accordingly, the Board has not proposed to amend the definition of prior period errors or to provide guidance on how to apply that definition. The Board acknowledged that assessing the nature of a change that results from an agenda decision could require judgement. However, as stated in paragraph BC15, it is the Board's view that the requirements in IAS 8 provide an adequate basis for making that judgement. The Board also noted that it would be inappropriate to characterise all changes that result from an agenda decision as the correction of an error, a voluntary change in accounting policy or a change in accounting estimate in part because the nature of the change is likely to vary by entity.

The timing of application of changes that result from an agenda decision

BC18 As noted in paragraph BC3(b), the new information provided by the explanatory material in agenda decisions might be viewed as being effective immediately upon publication. If so, an entity could find it difficult in some circumstances to change its accounting to reflect this new information. For example, assume the Committee publishes an agenda decision in June of a particular year and an entity with an annual reporting period ending on 31 December is expected to change its accounting policy as a result of the agenda decision. Depending on the change, it could be difficult for the entity to apply that change to its interim financial report(s) of the same year.

BC19 For this reason, the Board considered whether and how it might address when an entity applies a change in accounting policy that results from an agenda decision. The Board noted that there is no obvious way for it to address the matter. This is because agenda decisions are non-authoritative and any resulting change in accounting policy is not one that is required by IFRS Standards. Accordingly, it is difficult for the Board to address the timing of a voluntary change.

BC20 The Board considered amending IAS 8 to require the application of a voluntary change in accounting policy that results from an agenda decision only from the beginning of the next annual reporting period, ie the first annual reporting period beginning after publication of the agenda decision. Some Board members supported this approach because it would provide an entity with some time to implement a change in accounting policy that results from an agenda decision. However, the approach would also have prevented an entity from applying any such change before the next annual reporting period. A variation of this approach would be to require the application of such a voluntary change no later than the beginning of the next annual reporting period, which would permit application of the change from the date of publication of the agenda decision. However, that approach might not have resolved the difficulty faced by an entity that is expected to apply the change immediately, for example, due to local regulations.

BC21 The Board decided not to propose amending IAS 8 to address when an entity applies a change in accounting policy that results from an agenda decision. Instead, the Board decided to outline in the Basis for Conclusions its views on implementing such changes as a means of helping entities apply a change that results from an agenda decision (see paragraph BC22).

BC22 The Board observed that when the Board develops new requirements or amends existing requirements, the *Due Process Handbook* requires it to consider whether those applying IFRS Standards have sufficient time to prepare for the new or amended requirements. Similarly, when an entity voluntarily changes an accounting policy, it would generally plan to have sufficient time to prepare for the new policy. The Board is therefore of the view that an entity should equally be entitled to sufficient time to prepare for a change in accounting policy that results from an agenda decision. Determining what 'sufficient time' to implement a change is requires judgement, and will depend on the nature of the change. However, in the Board's view, it would generally be unreasonable to expect an entity to apply a change in accounting policy that results from an agenda decision immediately upon publication of that agenda decision. For example, depending on the particular facts and circumstances, it would generally be unreasonable to expect an entity with an annual reporting period ending on 31 December to apply in its interim financial report(s) of that year a change that results from an agenda decision published in June of the same year.

EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho
NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	20 April 2018
To:	NZASB Members
From:	Vanessa Sealy-Fisher
Subject:	**IPSASB ED 64 *Leases***

Purpose and introduction[1]

1. The purpose of this agenda item is to:

   (a) seek the Board's preliminary views on the proposed accounting for concessionary leases (leases at below market terms) by both lessees and lessors in ED 64, in particular, whether lessees and lessors should recognise the subsidy (non-exchange component) of a concessionary lease in their financial statements; and

   (b) seek the Board's feedback on the draft comment letter developed to date.

2. At the March meeting, the Board considered a comparison of (i) the lessor accounting proposed in International Public Sector Accounting Standards Board (IPSASB) Exposure Draft 64 *Leases* (ED 64); (ii) the current accounting in IPSAS 13 *Leases* (which is based on IAS 17 *Leases*); and (iii) the approaches proposed by the International Accounting Standards Board (IASB) in IASB ED/2010/9 *Leases* (that is, the performance obligation approach and the derecognition approach).

3. The majority of the Board members agreed that the derecognition approach for lessor accounting is the best approach conceptually. However, they expressed support for the lessor accounting in IFRS 16 *Leases* rather than the proposals in ED 64. This has implications for the accounting for concessionary leases proposed in ED 64 because the proposals are based on the right-of-use (ROU) model of lessor accounting also proposed in ED 64.

4. ED 64 contains the following proposals for accounting for concessionary leases, based on the right-of-use models of accounting proposed for lessees and lessors.

   (a) At lease commencement date, a <u>lessee</u> recognises an ROU asset (at the present value of the *market* lease payments), a lease liability (at the present value of the *contractual* lease payments) and revenue/liability for the subsidy (in accordance with IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*).

   (b) At lease commencement date, a <u>lessor</u> recognises a lease receivable (at the present value of the *contractual* lease payments), a liability (unearned revenue) (at the present

[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).

value of the *market* lease payments) and an expense for the subsidy, which is expensed immediately.

5. The proposed accounting is further explained in agenda item 6.2.

6. Agenda item 6.3 is a first-draft of the Board's comment letter on ED 64 regarding the proposals for lessee and lessor accounting. The comments on the proposed lessor accounting model are based on the feedback provided by the Board at the March meeting.

Recommendations

7. We recommend that the Board considers:

   (a) agenda item 6.2 in order to form its views on the proposed accounting for concessionary leases by both lessees and lessors in ED 64, in particular, whether lessees and lessors should recognise the subsidy (non-exchange component) of a concessionary lease in their financial statements; and

   (b) agenda item 6.3 and provides feedback on the draft comment letter.

Next steps

8. We are meeting with staff from the Treasury, Office of the Auditor General and Audit New Zealand on Monday 23 April 2018. A verbal update on that meeting will be provided at the May Board meeting.

9. Decisions and feedback received from this meeting will be incorporated into the draft comment letter to the IPSASB.

10. We will be seeking approval of the draft comment letter to the IPSASB on ED 64 at the June meeting.

Attachments

Agenda item 6.2:	Memo on Concessionary Leases
Agenda item 6.3:	Draft Comment Letter on ED 64
Agenda item 6.4:	ED 64 (in supporting papers)
Agenda item 6.5:	ED 64 At A Glance (in supporting papers)

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	20 April 2018
To:	NZASB Members
From:	Vanessa Sealy-Fisher
Subject:	**IPSASB ED 64 *Leases – Concessionary leases***

Purpose and introduction[1]

1. The purpose of this agenda item is to seek the Board's preliminary views on the accounting for concessionary leases (leases at below market terms) by both lessees and lessors as proposed in International Public Sector Accounting Standards Board (IPSASB) Exposure Draft 64 *Leases* (ED 64). In particular, we are seeking the Board's views on whether lessees and lessors should recognise the subsidy (non-exchange component) of a concessionary lease in their financial statements and, if so, how that subsidy should be accounted for.

2. The accounting requirements for leases for zero or nominal consideration are considered at the end of this memo.

3. The IPSASB recognised that public sector entities often enter into concessionary leases. IFRS 16 *Leases* and IPSAS 13 *Leases* (and PBE IPSAS 13 *Leases)* currently require leases to be measured at cost, with no guidance on how to account for leases on concessionary terms. The IPSASB also recognised that public sector entities often enter into leases for zero or nominal consideration, and that accounting standards do not currently contain requirements or guidance on how to account for these types of leases. A consequence of this lack of requirements and guidance results in diversity in practice when accounting for concessionary leases by both lessees and lessors. In many instances, the concession is neither recognised nor is it disclosed in the notes to the financial statements.

4. Therefore, the IPSASB decided to propose in ED 64 new public sector specific requirements to account for concessionary leases which are based on the right-of-use (ROU) models of accounting by lessees and lessors, also proposed in ED 64.

5. At its March meeting, the Board did not agree with the proposed ROU model for lessors, which has implications for the lessor accounting for concessionary leases proposed in ED 64.

[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).

Rather, the Board expressed support for the lessor accounting in IFRS 16 *Leases*, which requires a lessor to classify a lease as an operating lease or a finance lease.

Recommendation

6. We recommend that the Board forms a view on whether lessees and lessors should recognise the subsidy of a concessionary lease in their financial statements and, if so, how that subsidy should be accounted for.

Structure of the memo

7. This memo is structured as follows:

   (a) Proposed accounting for concessionary leases;

   (b) Proposed accounting for concessionary leases by lessees;

   (c) Proposed accounting for concessionary leases by lessors;

   (d) Leases for zero or nominal consideration; and

   (e) Next steps.

Proposed accounting for concessionary leases

8. A concessionary lease is defined as a lease at below market terms.[2]

9. The IPSASB is of the view that:

   (a) a concessionary lease comprises an exchange transaction (the market terms portion) and a non-exchange transaction (the concessionary portion);

   (b) leases that are exchange transactions should be measured at cost and concessionary leases should be measured at fair value; and

   (c) the granting of a concessionary lease is similar to the granting of a concessionary loan, therefore they should be accounted for in a similar manner.[3]

10. ED 64 contains the following proposals for accounting for concessionary leases, based on the ROU models of accounting proposed for lessees and lessors.

   (a) At lease commencement date, a <u>lessee</u> recognises an ROU asset (at the present value of the *market* lease payments), a lease liability (at the present value of the *contractual* lease payments) and revenue/liability for the subsidy (in accordance with IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*).

   (b) At lease commencement date, a <u>lessor</u> recognises a lease receivable (at the present value of the *contractual* lease payments), a liability (unearned revenue) (at the present

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2 Leases for zero or nominal amounts are considered to be in the nature of a grant and are, therefore, outside the scope of ED 64 and accounted for as a non-exchange transaction (see paragraphs 15, AG60 and BC21).

3 See the Appendix to this memo for a comparison of the accounting for a concessionary loan in accordance with IPSAS 29 *Financial Instruments: Recognition and Measurement* and the accounting for a concessionary lease by a lessor as proposed in ED 64 prepared by IPSASB staff and included in IPSASB meeting papers. The example shows the ledger accounts using coloured text.

value of the *market* lease payments) and an expense for the subsidy, which is expensed immediately.

11. The proposals are best illustrated by means of an example. The same information is used for both the lessee accounting and the lessor accounting.

<table>
<tr><td colspan="2">Example
A lease is granted for 10 years on a building. The market lease payments are $100,000 per year and contractual lease payments are $50,000 (annual subsidy of $50,000). For simplicity, assume discounting of the lease liability/lease receivable results in interest expense/revenue of $5,000 per year.</td></tr>
<tr><td>Lessee</td><td>Lessor</td></tr>
<tr><td>• Assume IPSAS 23 requires the subsidy to be recognised as a day one gain (no present obligation) in surplus or deficit
• Applies the cost model and depreciates the ROU asset on a straight-line basis over 10 years</td><td>• Assume the subsidy is recognised as a day one expense in surplus or deficit
• Underlying leased asset remains on the statement of financial position – cost of $10m is depreciated over 50 years</td></tr>
<tr><td colspan="2">Recognition at lease commencement date</td></tr>
<tr><td>Dr ROU asset 900,000
Cr Lease liability 450,000
Cr Revenue (subsidy) 450,000
(Non-exchange component recognised as a day one gain in surplus or deficit)</td><td>Dr Lease receivable 450,000
Dr Subsidy expense 450,000
Cr Liability (Unearned revenue) 900,000
(Non-exchange component recognised as a day one loss in surplus or deficit)</td></tr>
<tr><td colspan="2">Subsequent accounting</td></tr>
<tr><td>Dr Lease liability 45,000
Dr Interest expense 5,000
Cr Bank 50,000
(Lease payment made)</td><td>Dr Bank 50,000
Cr Lease receivable 45,000
Cr Interest revenue 5,000
(Lease payment received)</td></tr>
<tr><td>Dr Depreciation 90,000
Cr ROU asset 90,000
(Straight-line depreciation of ROU asset for 1 year)</td><td>Dr Liability (unearned revenue) 90,000
Cr Lease revenue 90,000
(Lease revenue recognised at fair value of the lease over the lease term)</td></tr>
<tr><td></td><td>Dr Depreciation 200,000
Cr Lease Asset 200,000
(Annual depreciation of underlying leased asset)</td></tr>
</table>

Measurement of a concessionary lease

12. The IPSASB considered three options for measuring leases, including concessionary leases. Those options were:

    (a) Option 1: Measure all leases at fair value regardless of whether they are concessionary;

    (b) Option 2: Measure leases that are exchange transactions at cost and measure concessionary leases (non-exchange transaction) at fair value; and

    (c) Option 3: Measure concessionary leases at cost and provide disclosures.

13. The IPSASB decided to measure leases that are exchange transactions at cost and measure concessionary leases at fair value because:

    (a) cost would not capture the subsidised component in a concessionary lease; and

    (b) the right-of-use asset would be undervalued if not measured at fair value.

Proposed accounting for concessionary leases by lessees

14. The IPSASB is of the view that the existing principles in IPSAS 23 for recognising revenue from non-exchange transactions are also applicable to the non-exchange component in a concessionary lease for lessees.

15. The proposals in ED 64 would require the lessee to recognise the subsidy as revenue (or as a liability if the lease includes stipulations over use which are considered to be conditions as defined in IPSAS 23). Where it is not possible to distinguish separate exchange and non-exchange components, the whole concessionary lease is treated as a non-exchange transaction. This includes leases for zero or nominal consideration, which are discussed in paragraphs 65–71 at the end of this memo.

16. Measuring the concessionary lease at fair value is also consistent with the requirements in IPSAS 23 to measure an asset initially acquired through a non-exchange transaction at fair value (see paragraph 42 of IPSAS 23).

Feedback received from outreach events

17. We have received mixed feedback from attendees at our outreach events[4] and from the Technical Reference Group (TRG) meeting held in April.

18. There was some support for the approach proposed in ED 64: it was considered appropriate that a lessee reflect the benefits received from concessionary leases (effectively to recognise the donation). However, support for this approach was stronger if the lessee was permitted to recognise the subsidy over the lease period regardless of whether or not the lease includes conditions as defined in IPSAS 23. There was some pushback on measuring the fair value of the concession due to the cost/benefit considerations.

19. Feedback received from outreach events includes the following.

    (a) Concerns about cost-benefit considerations of the proposals, in particular:

        (i) determining the fair value of a concessionary lease (for example, costs (in particular as local governments have hundreds of these types of leases);

        (ii) the measurement is judgemental;

        (iii) how to measure the lease at fair value when the underlying assets have a specific public benefit purpose or restricted use (for example, a school);

        (iv) the right to use in perpetuity;

        (v) the relevance of the information to users; and

        (vi) materiality.

    (b) The purpose of concessionary leases for lessees is to provide for the entity to spend its resources to benefit the community rather than incurring the cost of a lease on

[4] IPSASB roundtables held in Wellington and Auckland in February, XRB roundtables held in Wellington, Christchurch and Auckland in March, and a presentation to the Society of Local Government Managers (SOLGM) in Christchurch in March.

commercial terms. Spending money annually on obtaining valuations for concessionary leases is not the best use of public monies, especially when funding is usually quite hard to come by for smaller entities.

(c) Some attendees supported the IPSASB's proposed approach, acknowledging that not-for-profit entities (NFPs) will likely push back on the grounds of the costs exceeding the benefits. It was considered that recognising concessionary leases at fair value increases transparency for decision-makers and provides the full picture of the concessions received.

(d) There was uncertainty regarding the distinction between concessionary leases at below market terms and leases for zero or nominal consideration, particularly if they would be accounted for and measured in the same manner (that is, at fair value).

(e) There was agreement that the forthcoming standard needs to deal with concessionary leases but there needs to be a practical solution. For example, note disclosure of the concessionary lease, including the entity's "best estimate" of what the market rate would be.

(f) Concerns were expressed about recognising the subsidy in full on day one as this could affect the entity's ability to raise future funds. Providers of funding are more likely to think that the entity has sufficient funds.

20. In response to feedback received that it could be costly for lessees to determine the fair value of a concessionary lease, we are of the view that this concern might be mitigated in circumstances where there are restrictions contained in the lease or the asset subject to the lease is of a specialised nature. In these case, the fair value of the lease might not be significantly different from the contractual value of the lease because of the impact of the restrictions or the specialised nature of the asset on potential market rental income. In these circumstances, it could be determined that the lease is a lease at market terms rather than a concessionary lease.

21. We think that the IPSASB will need to give careful consideration to how it defines the fair value of a lease where the lease contains conditions/restrictions or it is for an asset of a specialised nature. In particular, a question of how the principle of highest and best use should be applied in the public sector when assets are held for their potential to provide services to the public.

Should lessees recognise the subsidy of a concessionary lease?

22. If the IPSASB decides that lessees should recognise the subsidy of a concessionary lease, we agree that this should be recognised in accordance with IPSAS 23, and that the accounting for the subsidy should be included in IPSAS 23.[5] This is consistent with the accounting for other non-exchange transactions, in particular, the recognition of donated assets. However, constituents would prefer that the subsidy be recognised over the term of the lease rather than on day one. We note that one constituent has asked whether the subsidy would be

[5] Lease contracts within the scope of IFRS 16 *Leases* are excluded from the scope of IFRS 15 *Revenue from Contracts with Customers.*

recognised over the term of the lease under the IPSASB's revenue project. The IPSASB is considering feedback received on its revenue project, including that IPSAS 23 is too restrictive in only allowing non-exchange revenue to be recognised over time where there is a condition. Under the public sector performance obligation approach proposed in the IPSASB Consultation Paper *Revenue and Non-Exchange Expenses*, there may be more flexibility for the subsidy to be recognised over the lease period.

23. Many constituents were of the view that note disclosure of the subsidy of a concessionary lease by lessees would be appropriate for cost-benefit reasons. If this option is proposed in our comment letter, then the IPSASB would need to consider the impact of this option on paragraphs 84 and 85 of ED 64 (which are shown below).

> Lessee: Other Measurement Models
>
> 84. **If a lessee applies the fair value model in IPSAS 16 to its investment property, the lessee shall also apply that fair value model to right-of-use assets that meet the definition of investment property in IPSAS 16.**
>
> 85. If right-of-use assets relate to a class of property, plant and equipment to which the lessee applies the revaluation model in IPSAS 17, a lessee may elect to apply that revaluation model to all of the right-of-use assets that relate to that class of property, plant and equipment.

24. If lessees do not recognise the subsidy of a concessionary lease but then revalue the ROU asset, the difference between the initial cost (based on the contractual payments) and the revaluation would be treated as a revaluation gain rather than as revenue from a non-exchange transaction in accordance with IPSAS 23.

25. A suggestion to overcome this problem is to *require* lessees that subsequently measure the ROU asset at fair value under paragraph 84 or that elect the revaluation model under paragraph 85 to recognise the subsidy on day one, and to provide an *option* for lessees that subsequently measure the ROU asset under the cost model to elect not to recognise the subsidy.

26. If the Board decides that lessees should provide note disclosures rather than recognise the subsidy, we would recommend in our comment letter that the IPSASB consider the implications of requiring only note disclosure on paragraphs 84 and 85 of ED 64.

27. We regularly hear that constituents do not support options in accounting standards so we would prefer not to propose including an accounting option in an IPSAS to the IPSASB.

Questions for the Board

1 Should lessees be required to recognise the subsidy of a concessionary lease, and if so,

(a) should the subsidy be accounted for in accordance with IPSAS 23?

(b) should the subsidy be recognised in full on day one or recognised over the term of the lease?

2 If lessees are not required to recognise the subsidy of concessionary leases, should the lessee be required to disclose information about those subsidies in the notes to the financial statements?

Proposed accounting for concessionary leases by lessors

28. At the March meeting, the Board did not agree with the ROU model proposed for lessor accounting. This has implications for the proposed lessor accounting for concessionary leases because the proposals in ED 64 are based on the ROU lessor model.

29. The question that we are seeking to address is whether or not the lessor should recognise in its financial statements the subsidy expense of a concessionary lease and, if the subsidy is recognised, how it should be accounted for.

***Accounting for the credit entry by the lessor*[6]**

30. The IPSASB is of the view that:
    (a) leases are financings of the right to use an underlying asset (paragraphs BC6, BC35 and BC80);
    (b) an outstanding loan and a lease receivable have the same economic nature because both have fixed or determinable payments, therefore the financing components of loans and leases are comparable transactions (paragraph BC80); and
    (c) the nature of the resources transferred (that is, granting a loan or transferring a right-of-use asset at below market terms) does not affect the economic substance of a subsidy (paragraph BC82).

31. The IPSASB considered the following three options for the lessor to account for the subsidy (non-exchange component) of a concessionary lease.
    (a) Option 1: Measure concessionary leases at cost – no recognition of the subsidy component.
    (b) Option 2: Measure concessionary leases at fair value – the expense (subsidy, the debit) is recognised in surplus or deficit and the credit entry for the non-exchange component is recognised as a liability (unearned revenue) together with the exchange component of the lease, and unwinds as revenue over the term of the lease.
    (c) Option 3: Measure concessionary leases at fair value – both the subsidy and the credit entry for the non-exchange component are recognised directly in net assets/equity.

32. The IPSASB rejected Option 3 (recognition of the credit entity in net assets/equity) because the subsidy component of the credit entry does not meet the definition of net assets/equity in IPSAS 1 *Presentation of Financial Statements* because it is not consistent with any of the four components of net assets/equity.[7]

33. The main difference between Options 1 and 2 is whether or not the subsidy is recognised by the lessor.

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6 See paragraphs BC77–BC96 of ED 64.

7 The four components of net assets/equity are (i) contributed capital, (ii) accumulated surpluses or deficits, (iii) reserves, and (iv) non-controlling interests (paragraph BC45 of ED 64).

34. Option 2 is proposed in ED 64 because the IPSASB considers that it is consistent with the:

    (a) definitions of revenue and liability in the IPSASB Conceptual Framework because they can arise from non-exchange transactions;

    (b) principles in the IPSASB Conceptual Framework, IPSAS 16 *Investment Property*, IPSAS 17 *Property, Plant and Equipment*, IPSAS 23 and IPSAS 29 *Financial Instruments: Recognition and Measurement* to measure non-exchange transactions at fair value; and

    (c) accounting for the subsidy:

        (i) in concessionary loans[8] as an expense (or contribution from owners) on day one and as (interest) revenue over the loan term; and

        (ii) by lessees in concessionary leases.

35. When discussing the accounting for a concessionary loan, the IPSASB concluded that the initial granting of the loan results in a commitment of resources: a loan and a subsidy on day one, and initial recognition of the subsidy expense (on day one) provides useful information for accountability purposes (paragraphs BC14 and BC15 of IPSAS 29). The lender subsequently applies IPSAS 29 and measures the loan at amortised cost using the effective interest rate method. Applying concessionary loan accounting to concessionary leases means that the initial granting of a concessionary lease results in the commitment of a resource (in the form of a right-of-use asset) and a subsidy on day one, and initial recognition of the subsidy on day one also provides useful information for accountability purposes.

36. The IPSASB also concluded that recognising unearned revenue over the term of the lease is consistent with the recognition of revenue by a grantor under the grant of a right to an operator model for service concession arrangements in IPSAS 32 *Service Concession Arrangements: Grantor* and the recognition of revenue in IPSAS 9 *Revenue for Exchange Transactions*. Recognising a liability is also appropriate until the criteria for recognising revenue have been satisfied.

Concerns raised regarding the credit entry to liability (unearned revenue)

37. The New Zealand IPSASB member expressed the following reservations about the credit entry by the lessor.

    (a) Whether a concessionary lease is, in substance, the same or very similar to a concessionary loan.

    (b) The nature of the credit entity in a concessionary lease and, in particular, whether presenting unearned revenue that is greater than the lease receivable is faithfully representative of that revenue and relevant to depictions of a lessor's financial performance and financial position.

38. The New Zealand IPSASB member had no concerns regarding the accounting treatment for concessionary loans. In the member's view, the lender advances a nominal amount of cash to

[8] See the Appendix to this memo for a comparison of the accounting for a concessionary loan and the accounting for a concessionary lease prepared by IPSASB staff and included in IPSASB meeting papers.

a borrower, and the lender initially writes down the loan asset to fair value (the credit entry) and recognises a concession expense on day one (the debit entry). Subsequently, as the repayments of the nominal amount are made, the lender's the initial loan write-down is unwound over the term of the loan as interest income using the effective interest rate method.

39. The concern with crediting the entry for a concessionary lease to unearned revenue is that the lessor's unearned revenue (and therefore annual revenue) would be inflated because of a below market arrangement (after showing a day-one expense). The lessor has not earned the revenue related to the subsidy so showing this as revenue is not a faithful representation of the lease contract. This IPSASB member did not believe that the lessor's opportunity cost of entering into a concessionary financing arrangement (regardless of the reason) should be reflected in the lessor's revenue being grossed up (with a day-one expense).

40. There was also a concern with recognising the concession expense (subsidy) on day one. This is arguably quite misleading as the lessor is effectively continuously providing the subsidy over time. However, if the subsidy is to be deferred and spread to the statement of financial performance, then the IPSASB would need to justify what the deferred asset is on day one (which is, unfortunately, another example of the difficulties of grossing up the statement of financial position).

IPSASB's response to the above concerns

41. Accounting for the subsidised component in the liability (unearned revenue) (credit entry) arose from the IPSASB's decision that a lessor should recognise an expense for the subsidised component of a concessionary lease. A credit entity is necessary to balance the debit (expense) for the subsidised component.

42. Although an IPSASB member had previously expressed the view that the credit entry could be considered to be a trigger for impairment of the leased asset, and should therefore reduce the carrying amount of the asset, the IPSASB had already decided that a key principle of their ROU lessor model was that the underlying leased asset remains on the lessor's statement of financial position in its entirety at its carrying amount at the commencement of the lease (except for depreciation of the underlying asset in accordance with the relevant IPSAS).

43. The IPSASB considered the economics of the right-of-use model when applied to concessionary leases from the lessor's perspective. When a lease contract is signed, it creates a new resource (right-of-use asset) separate from the underlying asset. This right-of-use asset is not recognised by the lessor because it is transferred immediately to the lessee. In other words, a lease under the right-of-use model is, in substance, a sale of an unrecognised right-of-use asset.

44. In this context, the items that the lessor recognises in its financial statements are the result of transferring the new resource to the lessee as follows.

    (a) If the lease is at market terms, then the market lease payments are the same as the contractual lease payments (cash inflows).

(b) If the lease is at below market terms (concessionary lease), then the market lease payments are higher than the contractual lease payments (cash inflows).

45. This means that at initial recognition of a concessionary lease measured at fair value the lessor recognises:

Lease receivable Dr	Exchange component – contractual lease payments (future cash inflows)	Use or transfer of the economic value that resulted from the creation of the right-of-use asset
Concession expense Dr	Non-exchange component – value of subsidy in kind transferred to lessee	
Liability (unearned revenue) Cr	Exchange component and non-exchange component	Full economic value of the resource created

46. The IPSASB concluded that a performance obligation to provide access to the underlying asset exists regardless of the amount of cash being transferred. This means that the lessor's liability (unearned revenue) encompasses both an exchange component and a non-exchange component.

47. However, the IPSASB acknowledged (in the ED's Basis for Conclusions) that:

(a) recognising lease revenue in excess of the lease receivable can be considered counter-intuitive by those who view lease revenue as directly linked to cash inflows (contractual lease payments). This might raise understandability issues because some users may find it difficult to understand that recognising an expense for the subsidy implies recognising lease revenue in excess of the cash inflows over the lease term; and

(b) some preparers may find that the cost of providing information about lease revenue in concessionary leases at fair value is higher than its benefits, especially when some users might not understand the meaning of recognising lease revenue in excess of cash flows. Costs also include gathering sufficient information to determine whether leases are at below market rates.

48. The IPSASB decided that, on balance, ED 64 should require the recognition of the expense on day one and a credit to liability (unearned revenue) but acknowledged that others could come to a different conclusion. The IPSASB therefore agreed to seek feedback from its constituents as to whether the conceptual reasons for recognising the subsidy in concessionary leases are outweighed by understandability and cost-benefit considerations.[9]

Our response to the above

Is a concessionary lease similar to a concessionary loan?

49. We are of the view that a concessionary lease is not the same as, or similar to, a concessionary loan.

[9] See Specific Matter for Comment 4 in ED 64.

50. Our understanding of the granting of a concessionary loan is illustrated by means of an example.

Example

A loan of $100 (principal) with zero interest is granted (the transaction is not a transaction with owners). Market interest rates are 10% and the net present value of the future cash inflows (calculated at market rates) is $80.

A per paragraphs AG88 and AG89 of IPSAS 29, the $100 paid to the borrower is divided into two components.

New loan granted

Dr Loan	80	
Dr Grant expense	20	
Cr Bank		100

(Payment of the loan)

The future cash flows to be received over the term of the loan ($100 principal and zero interest per the loan documentation) are equivalent to a loan of $80 at normal market rates.

Although the loan is documented as $100 at zero interest, in economic terms, it is the same as a loan of $80 at 10% interest. The accounting reflects the economics, not the legal form (loan documentation) of the transaction.

Over the term of the loan the cash inflows are treated as representing $80 principal and $20 interest (under the effective interest rate method of measuring financial assets at amortised cost).

Some people refer to the interest recognised under the effective interest rate method as "reversing" the original $20 expense, but this is not reflective of the economics that the accounting is intended to show. The $20 is the interest revenue received on the $80 loan, and this is reflective of the actual cash flows received.

The mechanics of the effective interest rate method result in the expense and the interest revenue being the same amount (that is, $20), which is likely causing some confusion.

Existing loan and then concession granted

Dr Loan	100	
Cr Bank		100

(Loan at normal market rates)

Dr Expense	20	
Cr Loan		20

(Concession granted – no interest to be paid)

In this case, the loan is granted at $100 at normal market rates. The existing loan is subsequently written down to reflect the concession granted, that is, the loan is now interest free. The balance on the loan now represents principal of $80 with interest at normal market rates of $20, which is reflective of the actual cash flow received.

51. With a concessionary loan, once the grantor has paid out the cash, it no longer controls that asset (that is, the cash has been derecognised). However, with a concessionary lease, the lessor still has control over the leased asset as it remains on the lessor's statement of financial position (that is, the leased asset has not been derecognised).

52. If the IPSASB is of the view that a concessionary lease is the same as, or similar to, a concessionary loan, then we think that the granting of a concessionary lease is analogous to the granting of a concession on a loan that was originated at market terms. This means that the credit entry for the subsidy expense should be credited to the leased asset, which would reflect the lessor's loss of economic benefits over the term of the lease.

53. Recognising the credit entry as a reduction of the leased asset had previously been raised by an IPSASB member (see paragraph 42 of this memo). In that member's view, the granting of a concessionary lease is an impairment trigger for the underlying asset because the lessor might not obtain the same economic benefits from the asset that it would have obtained by using it in its own operations or by selling it. This could be the case where the lease is at zero cost or for nominal consideration.

54. However, the IPSASB has consistently expressed the view that an asset should be recognised or derecognised in its entirety in accordance with its Conceptual Framework.

Presenting revenue that is greater than the lease receivable

55. We agree with the New Zealand IPSASB member's views on this matter.

Feedback received from outreach events

56. Attendees at our outreach events did not support the IPSASB's proposed accounting for concessionary leases by lessors. In their views, the outcome in the statement of financial performance does not make sense.

57. There was also pushback on the proposals for cost-benefit reasons. For example, SOLGM reported that local governments have hundreds of concessionary leases and, in their view, the costs of determining the fair value of these leases would not exceed the benefits.

58. Feedback received from outreach events includes the following.

(a) Concerns about cost-benefit considerations of the proposals, for example, determining the fair value of a concessionary lease when the underlying assets have a specific public benefit purpose or restricted use, and the costs when local governments grant hundreds of concessionary leases and leases for zero or nominal consideration.

(b) Although many not-for-profit entities will likely push back on the grounds of the costs of the proposals exceeding the benefits, there was an acknowledgement that recognising concessionary leases at fair value increases transparency for decision-makers.

(c) The proposals appear to be requiring information about "what would have happened if the entity had…" rather than "what did the entity do …". Examples of where this is a concern were (i) if the ethos of the entity is to charge below market rates (for example, a church), and (ii) if a trust deed contains restrictions regarding lease payments that could be charged.

(d) Whether it is right to recognise a large expense on day one while lease revenue is recognised over the term of the lease. There is an understanding of the IPSASB's good intention but the practical application is not clear.

(e) There was some support for the derecognition approach, where the credit entry would be against the leased asset.

(f) The forthcoming standard needs to deal with concessionary leases but there needs to be a practical solution. Suggestions included:

- note disclosure of the concessionary lease and the types of assets, with some context around the lease;
- note disclosure, which includes the entity's "best estimate" of what the market rate would be; and
- make sure the auditor's hands are not tied by the requirements.

(g) It was also acknowledged that, for some lessors, cost-benefit considerations might be mitigated on the grounds of materiality.

(h) Rating agencies use cash flows for rating purposes so cash flows would be more relevant than the statement of financial performance.

(i) Some attendees were of the view that the proposals for accounting for concessionary leases in ED 64 are difficult to support conceptually.

(j) Aligning the accounting for concessionary leases with concessionary loans was considered to be appropriate as the lessor is effectively making a grant.

59. Feedback received from TRG members includes the following.

(a) The majority of TRG members were of the view that the lessor's credit entity for the recognition of the subsidy should be against the leased asset because the economic benefits of the leased asset are reduced for the lessor.

(b) One TRG member was of the view that the credit entry should not be against the leased property because the residual value of the property has not decreased (and it would normally increase): the lessor still has an investment in the property. However, it was noted that increases in the value of the property would not be recognised if the lessor measured the property using the cost model.

(c) A question was raised as to whether the lessor is giving up something if granting a concessionary lease is part of the entity's objectives. In these circumstances, the asset is being used as intended by the lessor and this is reflected in the depreciation charge for the asset.

(d) Some TRG members were of the view that recognising the subsidy as unearned revenue is more appropriate because the asset has not decreased in value and the unwinding of the subsidy reflects that the lessor has given away something of value. However, one member thought it was odd to recognise revenue when it will never be received.

(e) One TRG member was of the view that granting a concessionary loan is not the same as granting a concessionary lease. With a concessionary loan, the cash has been paid out. With a concessionary lease, the lessor still controls the asset.

Should lessors recognise the subsidy of a concessionary lease?

60. If the IPSASB decides that lessors should recognise the subsidy of a concessionary lease, we support the 'derecognition approach' whereby the credit entry would be to the underlying asset. We note that the majority of TRG members also supported this approach.

61. Using the example following paragraph 11 of this memo, the journal entries would be:

Example A lease is granted for 10 years on a building. The market lease payments are $100,000 per year and contractual lease payments are $50,000 (annual subsidy of $50,000). For simplicity, assume discounting of the lease liability/lease receivable results in interest expense/revenue of $5,000 per year. Assume the subsidy is recognised on day one as an impairment of the building. The underlying leased asset remains on the statement of financial position – original cost of $10m is depreciated over 50 years. For simplicity, also assume that the building is acquired at the commencement of the lease.
Recognition of the subsidy Dr Subsidy expense 500,000 Cr Leased asset 500,000 (Lease subsidy ($50,000 x 10 years) which will be recognised as a day one loss in surplus or deficit) **Annual depreciation** Dr Depreciation 190,000 Cr Leased asset/Prov for depreciation 190,000 (Annual depreciation ($10m – $500,000 / 50 years))

62. At the March meeting the Board expressed support for the IFRS 16 lessor accounting where a lessor classifies a lease as an operating lease or finance lease.

63. Where the lease is classified as an operating lease, the lessor continues to recognise the underlying asset so crediting the subsidy to the underlying asset is not a problem. Where the lease is classified as a finance lease, the underlying asset has effectively been sold so the subsidy is accounted for as part of the 'sale' of the asset.

64. In addition, at the March meeting the Board decided that the derecognition approach for lessor accounting was the more conceptually-based approach.

Questions for the Board

3 Should lessors be required to recognise the subsidy of a concessionary lease, and if so, should the subsidy expense be credited against the underlying asset rather than to unearned revenue?

4 If lessors are not required to recognise the subsidy of concessionary leases, should the lessor be required to disclose information about those subsidies in the notes to the financial statements?

Leases for zero or nominal consideration

65. Leases for zero or nominal consideration are effectively outside the scope of ED 64.

66. The IPSASB is of the view that leases for zero or nominal consideration do not meet the definition of a concessionary lease as defined in ED 64. The relevant definitions are:

> A concessionary lease is a lease at below market terms.
>
> A contract is an agreement between two or more parties that creates enforceable rights and obligations.

> A <u>lease</u> is a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time *in exchange for consideration* [emphasis added].

67. The IPSASB is also of the view that leases for zero or nominal consideration are, in substance, a grant in-kind and, therefore, outside the scope of ED 64 (paragraph BC21). If an entity has determined that a concessionary lease is a grant, the lease is accounted for as follows (paragraph AG60):

    (a) a lessee accounts for the concessionary lease received in accordance with IPSAS 23; and

    (b) a lessor accounts for the concessionary lease granted in accordance with the relevant international or national accounting standard.

68. ED 64 also proposes amendments to IPSAS 23 to require:

    (a) ROU assets acquired by a lessee through non-exchange transactions to be measured at fair value as at the date or acquisition; and

    (b) the fair value of ROU assets to be measured in accordance with ED 64.

69. We agree that measuring leases for zero or nominal consideration at fair value is consistent with how other non-exchange transactions are measured.

70. We have received feedback from one of our outreach events that some constituents are of the view that a lease for zero or nominal consideration could be considered to be services in-kind. This would mean an entity can choose whether to recognise the ROU asset and the revenue/liability (paragraph 98 of IPSAS 23).

71. We think it is unhelpful to refer lessors to "the relevant international or national standard" when there is no relevant international standard, and most jurisdictions are unlikely to have a domestic standard dealing with non-exchange expenses. In our view, the IPSASB should provide some specific requirements or guidance for lessors to account for leases for zero or nominal consideration.

Question for the Board	
5	Should the IPSASB provide specific requirements or guidance for lessors that grant leases for zero or nominal consideration to other entities?

Next steps

72. The Board's views will be incorporated into the draft comment letter.

Appendix

Accounting for the subsidy – Concessionary loan (Grantor)

Loan	$5,000
Loan term	5 years
Contractual interest rate	5%
Market interest rate	10%
Repayments (cash flow)	$1,155

Loan plan

Year	Op Bal	Int (5%)	Princ	Repay	Cl Bal	Repay	PV	Diff
1	5,000	250	905	1,155	4,095	1,155	1,050	105
2	4,095	205	950	1,155	3,145	1,155	954	201
3	3,145	157	998	1,155	2,147	1,155	868	287
4	2,147	107	1,048	1,155	1,100	1,155	789	366
5	1,100	55	1,100	1,155	-	1,155	717	438
Total		**774**	**5,000**	**5,774**		**5,774**	**4,378**	**1,396**

Fair value of loan plan

Year	Op Bal	Int (10%)	Repay	Cl Bal
1	4,378	438	1,155	3,661
2	3,661	366	1,155	2,872
3	2,872	287	1,155	2,004
4	2,004	200	1,155	1,050
5	1,050	105	1,155	-
Total		**1,396**	**5,774**	

Loan	5,000
FV Loan	4,378
Subsidy	622

Bank

Yr1	1,155	Yr1	5,000
Yr2	1,155		
Yr3	1,155		
Yr4	1,155		
Yr5	1,155		

Interest revenue

Yr1 S/D	438	Yr1	438
Yr2 S/D	366	Yr2	366
Yr3 S/D	287	Yr3	287
Yr4 S/D	200	Yr4	200
Yr5 S/D	105	Yr5	105

Interest is recognised as revenue over the term of the loan

Contractual interest	774
Subsidy interest	622
Market interest	1,396

Loan receivable

Yr1	4,378	Yr1	1,155
Yr1	438	Yr2	1,155
Yr2	366	Yr3	1,155
Yr3	287	Yr4	1,155
Yr4	200	Yr5	1,155
Yr5	105		
	5774		5774

Subsidy

Yr1	622	Yr1 S/D	622

The interest subsidy is recognised as an expense at initial recognition

Accounting for the subsidy – Concessionary lease (Lessor)

Annual market lease payments	$1,500
Annual contractual lease payments (cash flow)	$1,155
Market Interest Rate	10%
Lease term	5 years

			70% of		
	Undiscounted annual market lease payments	**PV of annual market lease payments**	**Undiscounted annual contractual lease payments**	**PV of annual contractual lease payments**	**Off-market portion of the lease**
Year 1	1,500	1,364	1,155	1,050	314
Year 2	1,500	1,240	1,155	955	285
Year 3	1,500	1,127	1,155	868	259
Year 4	1,500	1,025	1,155	789	236
Year 5	1,500	931	1,155	717	214
Total	**7,500**	**5,686**	**5,775**	**4,378**	**1,308**

	Op Bal	**Int (10%)**	**Contractual lease payments**	**Principal**	**Cl Bal**
Year 1	4,378	438	1,155	717	3,661
Year 2	3,661	366	1,155	789	2,872
Year 3	2,872	287	1,155	888	2,004
Year 4	2,004	200	1,155	955	1,050
Year 5	1,050	105	1,155	1050	-
		1,396			

Lease Receivable

Yr1	4,378	Yr1	1,155
Yr1	438	Yr2	1,155
Yr2	366	Yr3	1,155
Yr3	287	Yr4	1,155
Yr4	200	Yr5	1,155
Yr5	105		
	5,775		5,775

Liability (unearned revenue)

Yr1	1,137	Yr1	5,686
Yr2	1,137		
Yr3	1,137		
Yr4	1,137		
Yr5	1,137		
	5,686		5,686

Interest revenue

Yr1 S/D	438	Yr1	438
Yr2 S/D	366	Yr2	366
Yr3 S/D	287	Yr3	287
Yr4 S/D	200	Yr4	200
Yr5 S/D	105	Yr5	105

Bank

Yr1	1,155		
Yr2	1,155		
Yr3	1,155		
Yr4	1,155		
Yr5	1,155		

Lease revenue

Yr1 S/D	1,137	Yr1	1,137
Yr2 S/D	1,137	Yr2	1,137
Yr3 S/D	1,137	Yr3	1,137
Yr4 S/D	1,137	Yr4	1,137
Yr5 S/D	1,137	Yr5	1,137

Expense (subsidy)

Yr1	1,308	Yr1 S/D	1,308

Contractual lease payments	4,378
Subsidy in lease payments	1,308
Market lease payments	5,686

Comparison between a concessionary loan and a concessionary lease

Concessionary loan

Subsidy – recognised as an expense on initial recognition

Interest revenue – recognised over the term of the loan

Concessionary lease

Subsidy – recognised as an expense on initial recognition

Interest revenue – recognised over the term of the lease

Lease revenue – recognised over the term of the lease

NZ ACCOUNTING STANDARDS BOARD

[Date] June 2018

Mr John Stanford
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto
Ontario M5V 3H2
CANADA

Submitted to: www.ifac.org

Dear John

ED 64 *Leases*

Thank you for the opportunity to comment on ED 64 *Leases* (ED 64). The ED has been exposed in New Zealand and some New Zealand constituents may comment directly to you.

While we agree with the right-of-use model proposed for lessees in ED 64, we do not agree with the right-of-use model proposed for lessors.

[include main comments]

Our recommendations and responses to the Specific Matters for Comment are set out in Appendix 1 to this letter. Appendix 2 summarises the matters we considered in forming our views. If you have any queries or require clarification of any matters in this letter, please contact Vanessa Sealy-Fisher (Vanessa.Sealy-Fisher@xrb.govt.nz) or me.

Yours sincerely

Kimberley Crook
Chair – New Zealand Accounting Standards Board

WELLINGTON OFFICE Level 7, 50 Manners St, Wellington • **AUCKLAND OFFICE** Level 12, 55 Shortland St, Auckland
POSTAL PO Box 11250, Manners St Central Wellington 6142, New Zealand • PH +64 4 550 2030 • FAX +64 4 385 3256

WWW.XRB.GOVT.NZ

Appendix 1: Responses to Specific Questions for Comment

Specific Matter for Comment 1:
The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

Response to SMC1

The NZASB agrees with the IPSASB's decision to adopt the IFRS 16 right-of-use model for lessee accounting. We agree that the right-of-use asset and the lease liability meet the definition of, and the recognition criteria for, an asset and a liability respectively in the IPSASB's *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework).

Specific Matter for Comment 2:
The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

Response to SMC2

The NZASB does not agree with the IPSASB's decision to depart from the model for lessor accounting in IFRS 16 *Leases*. Also see our response to SMC3 below for further elaboration.

We agree that the lessor accounting in IFRS 16 (based on risks and rewards incidental to ownership) is not consistent with the lessee accounting (based on control), and that a control-based approach is more consistent with the Conceptual Framework. However, after having reconsidered the options considered over the course of IFRS 16's development and the matters that led the International Accounting Standards Board (IASB) to largely retain its previous lessor accounting requirements, we do not believe that the case put forward by the IPSASB for departing from IFRS 16 is strong enough.

(a) In our view the IPSASB has ignored factors, such as user information needs, that would support the retention of the IFRS 16 approach.

(b) The IPSASB has argued that the approach proposed in ED 64 is consistent with its Conceptual Framework and is an improvement on the IFRS 16 approach. We think that both of these arguments are debatable.

The IPSASB's key reasons for departing from IFRS 16 appear to be those outlined in paragraph BC10, in particular, consolidation issues. We are not convinced that the arguments surrounding consolidation are sufficiently different in the public sector to warrant a departure from IFRS 16.

There will always be adjustments needed for consolidation purposes, for example, to eliminate inter-entity transactions and to align accounting policies. Our specific concerns are as follows.

(a) Paragraph BC10(a) explains that if the lessor classifies the lease as a finance lease the underlying asset would not be recognised by either the lessee or the lessor, and that separate records would need to be maintained for consolidation purposes. We doubt that this situation would arise often in practice for the following reasons.

  (i) The types of leasing arrangements discussed in paragraph BC11 (where a centralised entity undertakes the property management for a government) are unlikely to involve finance leases. Feedback from New Zealand constituents indicated that these types of leases are classified as operating leases, in which case the underlying leased asset remains on the lessor's statement of financial position.

  (ii) The types of finance lease arrangement commonly seen in the corporate sector (such as manufacturers or dealors providing finance to customers, or banks providing financing to companies) are unlikely to occur in the public sector.

(b) Paragraph BC10(a) states that additional records would be needed if the lessor classifies a lease as an operating lease (because the lessor will not recognise a lease receivable but the lessee will recognise a lease liability). We question this statement on the following grounds.

  (i) At the consolidated level there would be no lease, and therefore no lease receivable. From the perspective of the consolidated reporting entity the lease accounting would need to be eliminated, and the underlying leased asset would be accounted for in accordance with the relevant standard. The creation of a lease receivable is not necessary to report assets in the consolidated financial statements.

  (ii) Paragraph BC10 seems to assume that the non-recognition of a lease receivable by the lessor would make it more difficult to eliminate the lease liability of the lessee during the consolidation process. However, even if the lessor recognised a lease receivable, the lease receivable and the lease liability would not necessarily be the same amount (for example, because of different discount rates). Also, there are other ways of eliminating lease accounting by the lessee and lessor for consolidation purposes that might be more efficient, irrespective of how the lessor accounts for the lease.

(c) According to paragraph BC10(b), using different accounting models in the financial statements of the lessor and the lessee may make leasing transactions less understandable to some users of the financial statements. However, there are some counter arguments that have not been explored in the Basis for Conclusions.

  (i) There is no discussion of whether applying a different lessor accounting model in the public sector to the lessor accounting model in the private sector would make the financial statements of public sector entities less understandable to users.

  (ii) One of the key reasons for the IASB retaining the existing lessor accounting model was that users of the financial statements preferred the existing approach to other approaches considered by the IASB. Other approaches considered by the IASB included an approach similar to the lessor model proposed in ED 64. This suggests that users of the financial statements would be better served by maintaining the current approach to lessor accounting. [1] As explained in our response to SMC3, there are valid reasons why the IASB retained the requirement for a lessor to classify a lease as either an operating lease or a finance lease.

In addition to the concerns raised about paragraph BC10, we are concerned about the impact of different accounting requirements for lessors where a public sector controlling entity prepares consolidated financial statements that include for-profit controlled entities. A significant amount of work will be required on consolidation where the controlled for-profit entity is a lessor that applies IFRS 16 and the public sector controlling entity applies the model proposed in ED 64. We are aware that New Zealand is not the only country that would be impacted by having a different accounting model under IPSAS Standards to the lessor model under IFRS 16.

Specific Matter for Comment 3:

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB's reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?

Response to SMC3

We do not agree with the right-of-use (ROU) lessor accounting model proposed in ED 64.

The IASB proposed a similar lessor model, the performance obligation approach, in IASB ED/2010/9 *Leases*. Many respondents to ED/2010/9 were of the view that this approach grosses-up (double-counts) assets in the statement of financial position. Some respondents questioned how one set of cash flows – those received from the lessee – could relate to both the lease receivable and the underlying asset. Many also questioned how the obligation to permit the lessee to use the asset would meet the definition of a liability. We agree with these comments.

Our views on the two approaches discussed in the Basis for Conclusions are explained below.

Concerns with Approach 1

Paragraph BC36 sets out the IPSASB's conclusions for proposing the ROU lessor accounting model in ED 64 (Approach 1). We have the following concerns with the conclusions reached.

(a) The IPSASB has concluded that the lessor has retained control of the entire underlying asset, but the Basis for Conclusions does not provide any explanation of how it reached that conclusion. In considering whether the lessor has control of the asset, we raise the following matters.

   (i) Paragraph 5.11 of the Conceptual Framework states that "…control of the resource entails the ability of the entity to use the resource (or direct other parties on its use)…".

[1] Appendix 2 of this memo outlines the matters we considered in forming our views on the proposals in ED 64. Those matters included some of the lessor models proposed by the IASB during the development of IFRS 16 and respondents' comments on the lessor models proposed.

However, as the lessor has transferred the right to use the underlying asset to the lessee for the term of the lease, it is unclear how the lessor can have the ability to use the underlying asset or direct other parties on its use during the term of the lease.

(ii) In our view, a comparison of the requirements in IPSAS 32 *Service Concession Arrangements: Grantor* with the proposed lessor accounting is not an appropriate comparison because the control that the grantor has over the service concession asset is not the same as the control that the lessor has over the underlying asset in a lease. A grantor controls or regulates the services that the operator must provide, to whom the operator must provide them and at what price (IPSAS 32, paragraph 9(a)). A lessor grants the lessee a right to use the underlying asset but has no say in how the lessee operates the asset, what services are provided and what price the lessee charges for those services. Therefore, we do not consider that comparing the IPSAS 32 right-to-operate model for grantors to the right-of-use model for lessor accounting should be a key driver for determining whether a right-of-use model should be applied for lessor accounting. In addition, this is one of those instances where the proposals in ED 64 are being based on standards-level requirements that have not yet been assessed for consistency with the Conceptual Framework.

(iii) The IASB has a similar definition of an asset as the IPSASB. However the IASB concluded that the rights of the lessor under a lease agreement consist of two sets of rights, being (i) the lease receivable, and (ii) the rights retained in the underlying leased asset (see paragraphs BC35–BC40 of IFRS 16), rather than the underlying asset itself.

(b) We also have concerns with the proposals in ED 64 for the recognition of a liability (unearned revenue) by the lessor as outlined below.

(i) Paragraph BC53 acknowledges that (i) recognising the credit entry as a liability until the revenue recognition criteria are met may not be consistent with the Conceptual Framework, and (ii) recognising revenue directly in the statement of financial position would not be consistent with existing IPSAS Standards. We are of the view that the credit entry does not meet the definition of a liability because there is no outflow of resources by the lessor.

(ii) One of the IPSASB's reasons for not adopting the IFRS 16 lessor model is that the "risks and rewards incidental to ownership" model in IFRS 16 is not consistent with the lessee accounting control-based model. However, ED 64 includes several references to IPSAS 9 *Revenue from Exchange Transactions*, which is also based on risks and rewards. We think it is inconsistent to argue against a risks and rewards approach and then refer a lessor to a standard that is based on that approach.

(iii) We question how a lessor can continue to have a performance obligation (to make the underlying leased asset available) over the term of the lease when the right to use the asset has been delivered to the lessee at the commencement of the lease.

(iv) Paragraph BC47 states that the IPSASB decided that the credit entry represents revenue. Paragraph 5 29 of the Conceptual Framework defines revenue as increases in net financial position of the entity, other than increases arising from ownership contributions. However, the lessor has not given up or exchanged anything to earn the revenue (the underlying asset is retained by the lessor in its entirety), it is purely the result of recognising a lease receivable (with which we have previously expressed concerns). We are of the view that reasoning along the lines of paragraph BC47 could set a precedent which results in an entity inflating its 'revenue' by recognising assets.

(c) We agree with the conclusion in paragraph BC 9(b) that the right-of-use asset and the underlying leased asset are different economic phenomena. However, it does not follow that the economic benefits/service potential embodied in the right-of-use asset are additional to the economic benefits/service potential embodied in the underlying leased asset.

Rejection of Approach 2 by the IPSAB

Paragraph BC38 states that Approach 2 is not consistent with IPSASB literature and provides four reasons to support this statement. We disagree with those reasons as follows.

(a) Paragraph BC38(a) states that Approach 2 is not consistent with the principles in other IPSAS Standards because it requires the derecognition of a portion of the underlying asset. However:

  (i) Paragraph 6.10 of the Conceptual Framework refers to the derecognition of an element, which in this case is an asset. An asset is defined in paragraph 5.6 of the Conceptual Framework as "A resource…". Paragraph 5.7 of the Conceptual Framework explains that "A resource is an item with service potential or the ability to generate economic benefits. Physical form is not a necessary condition of a resource. …" Nowhere in the discussion of assets does it suggest that resources, once recognised as an asset, are not somehow divisible. Simple examples such as cash and inventory are clearly divisible, and portions of the carrying amount are derecognised when assets are consumed or sold.

  (ii) Existing IPSAS Standards require the derecognition of portions of recognised assets. For example:

  - IPSAS 29 *Financial Instruments: Recognition and Measurement* requires the derecognition of a portion of a financial asset when it is transferred to another party (and certain criteria are met);
  - IPSAS 17 *Property, Plant and Equipment* requires the derecognition of parts of the property, plant and equipment (PP&E), for example, when replacing parts of the PP&E item or if part of a building is demolished. Although the division of the asset, and the derecognition of those parts of the asset that have been disposed of, is based on physical components, the basic point is that parts of the asset are derecognised; and
  - IPSAS 37 *Joint Arrangements* requires a party to a joint operation to recognise and derecognise portions of PP&E. For example, if a party to a joint arrangement transfers an item of PP&E into the joint arrangement, it must derecognise the share of the PP&E item now held by other parties to the joint arrangement while continuing to recognise the retained portion (its share of the asset now held jointly).

  (iii) The execution of the lease could be regarded as resulting in the entity derecognising the underlying leased asset in its entirety and recognising two new assets – the lease receivable and the residual ownership interest in the PP&E. So, in the same way that the right-of-use asset under a lease is a different economic phenomenon to the underlying asset (the PP&E), the residual ownership interest of the lessor in the underlying asset can be viewed as a different economic phenomenon from the underlying leased asset.

(b) Paragraph BC38(b) states that Approach 2 is not consistent with IPSASB literature because it is more complex and costly than Approach 1. Both approaches are more complex and costly than the existing lessor accounting so complexity and cost would be an argument for retaining the existing lessor accounting rather than for preferring one new approach over another new approach.

(c) Paragraph BC38(c) is using the current lessor accounting to explain why Approach 2 is inconsistent with a control-based approach to recognition and derecognition. We do not see how the rationale provided (why the classification of a lease as operating or finance is not control-based) relates to Approach 2 (which is a derecognition approach).

(d) Paragraph BC38(d) states that Approach 2 is not consistent with IPSAS 32's requirements. We have outlined our concerns with basing lessor accounting on the grantor accounting requirements in IPSAS 32 earlier in this letter. We are of the view that at some point the requirements of IPSAS 32 should be assessed against the Conceptual Framework for consistency, and this could result in changes to the requirements in IPSAS 32 and the Basis for Conclusions on IPSAS 32.

Our suggestion for lessor accounting

We recommend that the IPSASB redeliberate on the lessor accounting model proposed in ED 64. Appendix 2 to this comment letter outlines the approach we took in forming our views on the right-of-use lessor model. This involved comparing the model proposed in ED 64 with the lessor accounting model in IFRS 16 and the two lessor accounting models proposed by the IASB in ED/2010/9 (being the derecognition approach and performance obligation approach).

We are of the view that the derecognition approach proposed in ED/2010/9 is the more conceptually-based approach. Some respondents to ED/2010/9 supported the derecognition approach but disagreed with the proposals to prevent a lessor from accounting for the effects of the time value of money on the residual asset (the residual asset was not remeasured unless the lease term was reassessed (ED/2010/9, paragraph 56(a)) or it was impaired (ED/2010/9, paragraph 59). Based on the feedback received, the IASB issued ED/2013/6, which proposed a different lessor accounting model.

After considering feedback received from respondents to both ED/2010/9 and ED/2013/6, the IASB decided not to continue with any of the lessor models proposed in those EDs. Many respondents had expressed the view that the lessor accounting in IAS 17 *Leases* worked well in practice and should be kept. The IASB therefore kept the accounting requirement for a lessor to classify a lease as an operating lease or a finance lease in IFRS 16.

We support the lessor accounting requirements in IFRS 16 for the following reasons:

(a) We disagree with the ROU lessor model proposed in ED 64 for the reasons outlined above.

(b) Although we are of the view that a derecognition approach is more conceptually-based, this approach was not adopted in IFRS 16 and neither is it proposed in ED 64.

(c) In our view, leases that are classified as finance leases represent, in substance, the purchase (by the lessee) and sale (by the lessor) of the underlying asset in a secured financing arrangement. In other words, rather than simply creating a right-of-use asset for the lessee, these types of leasing arrangements are economically similar to the purchase of the item of property, plant and equipment with finance provided by the lessor.

(d) The leases project was initiated to address concerns about (i) lessee accounting and (ii) inadequate reporting of information about a lessor's exposure to credit risk (arising from a lease) and exposure to asset risk (arising from the lessor's retained interest in the underlying asset. The concern regarding disclosure by lessors has been addressed by requiring additional disclosures, particularly for leases of equipment and vehicles that were classified as operating leases.

Specific Matter for Comment 4:

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96) for IPSASB's reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB's reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?

Response to SMC4

[Response to be drafted following the NZASB's May meeting]

Other matters

New paragraph 105C of IPSAS 23

IPSAS 23 deals with revenue from non-exchange transactions. We think that the words "granted to or" in new paragraph 105C are not needed because the lessee (the recipient of the subsidy) not the lessor (the provider of the subsidy) would be applying IPSAS 23 to the subsidy received through a concessionary lease.

Concessionary Leases

105C. Concessionary leases (including concessionary leasebacks) are ~~granted to or~~ received by an entity at below market terms, including leases for zero or nominal consideration. The portion of the lease that is payable, if any, along with any interest payments, is an exchange transaction and is accounted for in accordance with [draft] IPSAS [X] (ED 64), *Leases*. An entity considers whether any difference between the consideration (lease payments) and the fair value of the lease on initial recognition (see [draft] IPSAS [X] (ED 64)) is non-exchange revenue that should be accounted for in accordance with this Standard.

Editorial corrections

Reference	**Correction needed**
Paragraph IG2 – should read "provide references) twice	Some diagrams below set out typical types of transactions involving identified assets and provide~~s~~ references to IPSASs that apply those transactions. Other diagrams identify types of leases and provide~~s~~ references to paragraphs in [draft] IPSAS [X] (ED 64).
Paragraph IG2 and Example 23	Should the reference to IPSASs be to IPSAS Standards?
Paragraph IG55	The title of IPSAS 9 should be italicised
Example 1A	Example 1A: A ~~a~~ contract…..
Example 1B	Example 1B: The ~~the~~ contract
Example 3B	Supplier makes all decisions about the transmission of ~~its customers'~~ Customer's data….
Example 9A	Example 9A: A ~~a~~ utility company
Example 12	…This is because: (a) Lessee can benefit from the use of….. … maintaining the ~~long-reach~~ computed tomography machine…
Example 22C	Segment as a column heading – the 'S' should not be underlined
Example 24	First journal entry Cr Lease liability 16,100,000

Appendix 2: Our deliberations regarding the proposed lessor accounting model in ED 64

Development of IFRS 16 *Leases*

Introduction

In forming our views on the right-of-use (ROU) model for lessor accounting proposed in ED 64, we considered some of the proposals of the International Accounting Standards Board (IASB) issued for comment during the development of IFRS 16 *Leases* and the feedback received on those proposals. Although one of the models proposed by the IASB in ED/2010/9 *Leases* (the performance obligation approach) was similar to the ROU model proposed in ED 64, respondents generally did not support that model.

We considered the following three lessor accounting models:

(a) the approach in IFRS 16 *Leases*, which requires that the lessor classify a lease as a finance lease or an operating lease, based on an assessment of whether the lessor transfers to the lessee substantially all the risks and rewards incidental to ownership of the underlying asset;

(b) the single right-of-use (ROU) lessor model proposed in ED 64, which applies to all leases; and

(c) the right-of-use lessor models proposed by the IASB in IASB ED/2010/9 *Leases* (ED/2010/9), which proposed that the lessor recognise an asset representing its right to receive lease payments and, depending on its exposure to risks or benefits associated with the underlying asset, apply either a performance obligation approach[2] (similar to the model proposed in ED 64) or a derecognition approach.[3]

The lessor models that we considered are summarised below.

IFRS 16 model	**Performance obligation approach (ED 64 and ED/2010/9)**	**Derecognition approach (ED/2010/9)**
Date of commencement of the lease		
<u>*Finance lease*</u>: The lessor: • Derecognises the underlying asset • Recognises a lease receivable (present value of future lease payments and any unguaranteed residual value) • Recognises a profit for any difference <u>*Operating lease*</u>: The lessor makes no entries	The lessor: • Does not derecognise the underlying asset • Recognises a lease receivable (present value of the future lease payments) • Recognises a lease liability (unearned revenue per IPSASB ED 64)	The lessor: • Derecognises the portion of the underlying asset associated with the economic benefits transferred to the lessee • Recognises a lease receivable (present value of the future lease payments) • Reclassifies as a residual asset the remaining economic benefits in the underlying asset • Recognises any gain or loss on derecognition of the underlying asset

2 The 2010 ED proposed this approach when the lessor retains exposure to significant risks or benefits of the underlying asset.

3 The 2010 ED proposed this approach when the lessor transfers significant risks or benefits of the underlying asset to the lessee.

<table>
<tr><th>IFRS 16 model</th><th>Performance obligation approach (ED 64 and ED/2010/9)</th><th>Derecognition approach (ED/2010/9)</th></tr>
<tr><td colspan="3">Subsequently</td></tr>
<tr><td><u>Finance lease</u>: The lessor
• Recognises cash received for the lease payments
• Recognises interest revenue (unwinding of lease receivable discount)
• Reduces the lease receivable (principal portion of the lease payment received)

<u>Operating lease</u>: The lessor:
• Recognises lease revenue for the amount of the lease payments received</td><td>The lessor:
• Recognises cash received for the lease payments
• Recognises interest revenue (unwinding of lease receivable discount)
• Reduces the lease receivable (principal portion of the lease payment received
• Recognises lease revenue as the liability (unearned revenue) is recognised in profit or loss/surplus or deficit over the term of the lease</td><td>The lessor:
• Recognises cash received for the lease payments
• Recognises interest revenue (unwinding of lease receivable discount)
• Reduces the lease receivable (principal portion of the lease payment received)</td></tr>
<tr><td colspan="3">Rationale for the models</td></tr>
<tr><td><u>Finance lease</u>
• The lessor has transferred substantially all the risks and rewards incidental to ownership of the leased asset to the lessee – this is, in substance, a sale of the leased asset
• The lessor is providing finance to the lessee over the term of the lease

<u>Operating lease</u>
• The lessor retains substantially all the risks and rewards incidental to ownership of the leased asset
• The lessee pays the lessor in exchange for using the leased asset</td><td><u>IPSASB and IASB</u>
• The lease creates a new asset, the right to receive lease payments, and a new lease liability, representing the obligation to permit the lessee to continue to use the underlying asset during the lease term (a ‘performance obligation’)
• The performance obligation is satisfied continuously during the lease term
• The asset and liability arising from the lease contract are separate from the underlying asset and should be accounted for separately
• The lessor does not lose control of the underlying asset – the lessor grants the lessee a right to use the asset in exchange for the lease payments
• The lessor has an unconditional right to receive lease payments as a result of transferring to the lessee the right to use the underlying asset</td><td>• The lessor has transferred to the lessee the rights to a significant portion of the future economic benefits associated with the underlying asset
• The lessor receives an unconditional right to receive payments from the lessee
• The lessor retains some of the economic benefits in the underlying asset – recognises a residual asset
• The lessor has met its performance obligation by transferring to the lessee the rights to use the underlying asset</td></tr>
</table>

IFRS 16 model	Performance obligation approach (ED 64 and ED/2010/9)	Derecognition approach (ED/2010/9)
	IASB only • The lessor has an obligation to permit the lessee to continue to use the underlying asset during the lease term. This obligation meets the definition of a liability in the IASB Conceptual Framework – a present obligation of the lessor arising from past events that would result in an outflow of future economic benefits from the lessor	

We did not consider the lessor accounting models proposed by the IASB in ED/2013/6 *Leases* because that exposure draft proposed a dual model for both lessees and lessors, and neither of the lessor models was similar to the ROU model proposed in ED 64.

Feedback received by the IASB on the lessor models proposed in ED/2010/9

Many respondents to ED/2010/9 disagreed with the lessor accounting proposals in that ED. We agree with many of those comments, including those of the Financial Reporting Standards Board (FRSB), the predecessor body of the New Zealand Accounting Standards Board. Comments on the lessor models proposed in ED/2010/9 by those who did not support aspects of the models included the following.

(a) Many, including the FRSB,[4] did not support the performance obligation approach. Many questioned how one set of cash flows—the cash flows to be received from the lessee—could relate to both the lease receivable and the underlying asset.

(b) Many also questioned how the obligation to permit the lessee to use the asset would meet the definition of a liability in the IASB's Conceptual Framework.

(c) Some supported applying the derecognition approach to all leases. However, many disagreed with the proposals to prevent a lessor from accounting for the effects of the time value of money on the residual asset.[5]

(d) Others said that the existing lessor accounting requirements work well in practice and supported retaining those requirements.

In addition to the comments above, the FRSB's comment letter included the following points.

(a) Finance and operating leases are different economically. There was a concern that the proposed lease accounting models ignored the distinction between the two.

(b) The FRSB recommended that the IASB strengthen the proposed criteria and guidance for distinguishing leases from in-substance purchases by adding to the criteria and guidance in

[4] The FRSB supported the derecognition approach.

[5] The residual asset was not remeasured unless the lease term was reassessed (paragraph 56(a) or it was impaired (paragraph 59).

IAS 17 *Leases* on distinguishing finance leases from operating leases. The FRSB also recommended:

(i) for leases that are in-substance purchases, retaining the existing accounting for finance leases under IAS 17; and

(ii) for other leases, introducing the right-of-use model but measuring the asset and liability recognised based on the minimum non-cancellable lease term and other payments that the lessee is obliged to make.

The FRSB was of the view that this would better reflect the substance of lease arrangements: finance leases are effectively in-substance purchases with secured financing and operating leases provide the lessee with a right of use and an unconditional obligation to make lease payments over the minimum lease period.

(c) The FRSB agreed that a lessor's right to receive rentals under a lease would meet the definition of an asset. The FRSB supported a single approach to lessor accounting – being the derecognition approach. The FRSB considered that the derecognition approach was consistent with the substance of a leasing arrangement (whereby the lessor's asset is no longer the whole leased item but is the portion of the leased item remaining after the lessee's use thereof).

(d) The performance obligation approach to lessor accounting is inconsistent with the lessee accounting model. It was not clear to the FRSB how the lessee could have received an unconditional right to use the leased asset over the lease term if the lessor continued to have an obligation to permit that use.

IFRS 16 lessor accounting

As discussed above, in 2019 the IASB sought feedback on proposals that would have removed the distinction between finance leases and operating leases. It then sought feedback on revised proposals in ED/2013/6 *Leases*. However, IFRS 16 still requires a lessor to classify a lease as a finance lease or an operating lease. The IASB's reasons for keeping this distinction in IFRS 16 are discussed below.

(a) In developing ED/2013/6 *Leases* the IASB considered whether lessors should recognise lease receivables as assets. The IASB acknowledged that all leases could give rise to a lease receivable of the lessor and that this lease receivable could meet the definition of an asset (see the Basis for Conclusions on ED/2013/6). However, even in ED/2013/6 the IASB did not propose that lessors recognise all lease receivables as assets. The IASB was very conscious of the earlier comments of respondents on ED/2010/9.

(i) Respondents to ED/2010/9 disagreed with the performance obligation approach because it would "gross-up" the lessor's balance sheet (together with a performance obligation liability).

(ii) Respondents to ED/2010/9 indicated that (a) the receivable and residual approach would be prohibitively complex to apply for leases of multi-tenanted property; and (b) for most property leases, existing lessor accounting worked well in practice and provided users with the information they needed, without adjustments.

(b) A majority of respondents to ED/2013/6 had explained that they viewed leases differently from a lessee's perspective (has the lessee recognised the assets and the liabilities arising from a lease) than from a lessor's perspective (when revenue from leasing activities is recognised and the accounting for the underlying assets). Many users of financial statements expressed the view that existing lessor accounting worked well in practice, whereas change was needed to existing lessee accounting.

(c) The requirement for a lessor to classify a lease as an operating lease or a finance lease would retain existing lessor accounting for all preparers in material respects. When compared to eliminating lessor accounting from the project entirely, this approach would achieve a converged lessor accounting model without introducing new concepts or resulting in inconsistencies (such as in lease definition, scope, etc) with the proposed lessee accounting model. In making this decision, the following feedback on ED/2010/9 and ED/2013/6 was considered.

(i) The main perceived deficiency in existing lease accounting was *lessee* accounting for existing operating leases – there had not been significant perceived deficiency in existing lessor accounting.

(ii) The majority of respondents supported a dual lessor model, with most of them expressing support for retaining the *existing* dual lessor model.

(iii) Many respondents to ED/2013/6 commented that the proposed changes to lessor accounting would result in accounting that does not align to the economics of all leases or to a lessor's business model.

(iv) Almost all users and preparers of financial statements for lessors of property generally supported the lessor accounting proposed in ED/2013/6, which was generally consistent with existing lessor accounting for such leases (ie operating leases).

Our view

We are of the view that the derecognition approach is the most conceptually sound model. However, this approach was not adopted in IFRS 16 for the reasons discussed above. We therefore support the model in IFRS 16.

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	20 April 2018
To:	NZASB Members
From:	Aimy Luu Huynh
Subject:	**IPSASB Proposed Strategy and Work Plan 2019–2023 Consultation**

Staff recommendations[1]

1. We recommend that the Board:

   (a) PROVIDES feedback on the draft comment letter on the IPSASB *Proposed Strategy and Work Plan 2019–2023* consultation; and

   (b) AGREES to finalise the draft comment letter via a subcommittee or the Chair of the NZASB (subject to the feedback from the Board).

Background

2. The IPSASB published its *Proposed Strategy and Work Plan 2019–2023* in February 2018. Comments were due to the NZASB by 13 April 2018 and to the IPSASB by 15 June 2018. We did not receive any submission from constituents.

3. Staff have updated the draft comment letter for the Board's comments from the March NZASB meeting.

4. Comments are due to the IPSASB before the June Board meeting so this meeting is the final chance for the full Board to provide feedback. Staff recommend the Board provides feedback on the draft comment letter and agree that the comment letter be finalised by a subcommittee of the Board (if there are substantial changes) or the Chair of the NZASB (if there are minor changes).

Attachments

Agenda item 7.2:	NZASB draft comment letter on IPSASB *Proposed Strategy and Work Plan 2019–2023*
Agenda item 7.3:	IPSASB *Proposed Strategy and Work Plan 2019–2023* (in supporting papers)
Agenda item 7.4:	Appendix B: Analysis of Potential Projects Against Selection Criteria (in supporting papers)

[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).

EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho
NZ ACCOUNTING STANDARDS BOARD

XX June 2018

Mr John Stanford
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto
Ontario M5V 3H2
CANADA
Submitted to: www.ifac.org

Dear John

Proposed Strategy and Work Plan 2019–2023

Thank you for the opportunity to comment on *Proposed Strategy and Work Plan 2019–2023* (the Consultation Document). The Consultation Document was exposed for comment in New Zealand and some New Zealand constituents may have made comments directly to you.

As you are aware, we have a keen interest in the IPSASB's strategy and work programme, given that the accounting standards which New Zealand public sector entities and not-for-profit (NFP) entities apply are based on IPSAS Standards.

We broadly support the specific proposals in the Consultation Document, as indicated in our response to the specific questions, which are set out in the Appendix to this letter.

The IPSASB has a number of significant projects to be completed over the next couple of years, most of which are addressing public sector specific issues. For the IPSASB to develop high-quality financial reporting guidance, we wish to stress the importance of taking the time to get things right rather than focusing on when outputs are produced. There is a risk that not all the issues are considered and adequately worked through when the focus is on quantity and speed rather than quality. A project could end up taking longer for a number of reasons. Focusing on quality rather than quantity also means that there should be sufficient comment period for due process documents. In order to provide high-quality comments to the IPSASB, respondents need adequate time to read and understand the due process documents, identify any issues, conduct outreach and to provide appropriate solutions if they are not provided in the proposals.

We recommend the IPSASB adds to the Work Plan 2019–2023 a project on the presentation of financial statements. We are of the view that this project is more prevalent and has more consequences than some of the other proposed projects in the Consultation Document. We are living in an environment where information is readily available from many sources. If the information in financial reports is not relevant and not presented in a clear and concise manner then it will be difficult for readers to understand and use for accountability and decision-making purposes.

We are very pleased that maintaining IFRS convergence is included as a separate theme in the Consultation Document. When transactions are the same for the public and private sector it is important that convergence with IFRS® Standards is maintained. Maintaining convergence with IFRS Standards ensure the IPSAS Standards incorporate the latest thinking of the International Accounting Standards Board (IASB), to the extent appropriate for the public sector. This process ultimately contributes to the IPSASB maintaining high-quality financial reporting guidance.

Although we are broadly supportive of the specific proposals in the Consultation Document, we have a number of comments and recommendations in our response to the Specific Matters for Comment (SMC), which are set out in the Appendix to this letter.

If you have any questions or require clarification of any matters in this submission, please contact Aimy Luu Huynh (aimy.luuhuynh@xrb.govt.nz) or me.

Yours sincerely

Kimberley Crook
Chair – New Zealand Accounting Standards Board

APPENDIX Response to Specific Matters for Comment

Specific Matter for Comment 1

Do you agree with the IPSASB's proposed Strategic Objective 2019–2023? If you agree please provide any additional reasoning not already discussed in the document. If you do not agree please explain your reasoning and your proposed alternative.

We broadly agree with the IPSASB's proposed overarching Strategic Objective 2019–2023. We suggest that the first area of activity can be enhanced if "and maintaining" is added after "developing". Adding maintaining makes it explicit that not only new guidance is developed but existing guidance is also enhanced and updated. The proposed amendments are marked-up below.

> Delivered through two main areas of activity, both of which have a public interest focus:
>
> - Developing and maintaining IPSAS and other high-quality financial reporting guidance for the public sector;

Note for the Board

We have thought about the most appropriate location for the point below. It has been suggested that this could be located in the project priorisation SMC. This point does not relate to any particular project and it is more about the IPSASB's process which is part of the strategy delivery. Therefore we thought it was most appropriate under SMC 1.

At the March meeting, the Board has suggested that the IPSASB should be explicit in that high-quality financial reporting guidance is from a principle-based approach. We are not proposing to add this point because high-quality principle based standards is noted in the Consultation Document under the section Managing strategy delivery and work plan output quality. See the extract below.

> *International Recognition*
>
> The strength of the IPSASB's reputation and global acceptance of the IPSAS—Managed through:
>
> Ongoing commitment to ensuring both the quality and timeliness of delivery of new standards. This includes developing high-quality principle-based standards that are usable and provide users with information that is relevant and faithfully representative; …

Other General Comments

We agree with the IPSASB's strategic focus on developing IPSAS Standards and other high-quality financial reporting guidance. However, we recommend the IPSASB can further enhance this activity by considering the following.

- *Quality be a priority over quantity*. Taking the time to get things right and less emphasis on the speed of output. There is a risk that not all issues are considered when the focus is on quantity and speed rather than quality. This may result in a more time-consuming remedy later such as amendments or improvements, which adds extra time to standard-setting. A project could end up taking longer, for example, there could be more than one due process document if respondents disagreed with the IPSASB's proposals. Even when a final standard is issued, constituents could identify issues with implementation and interpretation which could result in the IPSASB issuing subsequent amendments. The focus on quantity over quality also poses a reputation risk for the IPSASB which in turn could impact on the strategic objective of increasing the adoption of accrual-based IPSAS. We wish to emphasise the importance of this point especially for Theme A projects because the IPSASB are developing standards from scratch rather than being based on IFRS Standards.

- *Length of comment period*. Having a sufficient comment period for due process documents. The complexity of a topic should be a main factor in determining the length of the comment period rather than meeting milestones. In order to provide high-quality comments to the IPSASB, respondents need adequate time to read and understand the due process documents, identify any issues, conduct outreach and to provide appropriate solutions if it is not provided in the proposals.

  A sufficient comment period is required for respondents whom English is not their first language. For these respondents extra time is taken in translation between English and their first language. For example, they need to translate the due process document into their first language, formulate comments in their first language and then translate this into English for the IPSASB.

Specific Matter for Comment 2

Do you agree with the IPSASB's five proposed Strategic Themes for the 2019–2023 period? If you agree please provide any additional reasoning not already discussed in the document. If you do not agree please explain your reasoning, including any proposed alternatives.

We generally agree with the five proposed Strategic Themes for 2019–2023. The themes are consistent with the proposed overarching strategic objective. We are particularly pleased that maintaining IFRS convergence has been given more weighting with its own theme in the Consultation Document, whereas in the *IPSASB Strategy Document* of 2014 IFRS convergence was only a factor for project prioritisation.

In addition to the rationale provided in the Consultation Document for Theme B, we further support Theme B for the following reasons.

- When transactions are the same for the public and private sector and convergence with IFRS Standards are maintained, the IPSAS Standards are keeping up to date with the latest thinking.

- There are public sector entities that issue debt securities on international debt markets. For these public sector entities, when financial statements are prepared in accordance with IPSAS Standards, rather than IFRS Standards, the entities will often be required to explain to investors where there are differences from IFRS Standards. Generally, investors tend to have a better understanding of IFRS Standards. If investors don't understand the financial statements prepared in accordance with IPSAS Standards, and the reasons why they are different from IFRS Standards, then this may impact on their investment decisions.

- It is easier for accountants to transfer their skills set between private sector and public sector if the differences between IPSAS Standards and IFRS Standards are minimised.

- The adoption of IPSAS Standards will be more attractive for jurisdictions that currently apply IFRS Standards for public sector entities. In these jurisdictions, the transition to IPSAS Standards will be easier if the IPSAS Standards are aligned with the IFRS Standards.

We acknowledge the IPSASB will have challenges in prioritising the right balance of projects and activities among the five themes, in particular, the projects in Themes A and B. Some ways to overcome this challenge is for projects to have a clearly defined scope, and ensure that preliminary research is carried out. This work would determine which theme each project falls under. For example, if a project falls under Theme C it would require less resources than under Theme A. There are some projects where there could be an overlap between Theme A and Theme B such as presentation of financial statements. We discuss this further in SMC 4 below.

Specific Matter for Comment 3

Do you agree with the criteria the IPSASB has used in deciding the proposed issues to add to its Work Plan 2019–2023? If you agree please provide any additional reasoning not already discussed in the document. If you do not agree please explain why, including any proposed alternatives.

<u>Note for the Board</u>

In the March paper, we had a staff point on expanding the consequences criterion to include the communication effectiveness initiative and focus on information that meet users' needs. We have reconsidered this point and the explanation for the consequences criterion in the Consultation Document is broad enough to cover communication effectiveness. We are not proposing to add this point in the draft comment letter.

We generally agree with the criteria for project prioritisation, there is a good mix of factors to consider. However, it is not clear in the Consultation Document if all four proposed criteria are required or only some in order for a project to be added to the work plan. We recommend that this matter is clarified.

To assist the IPSASB with selecting a project under the prevalence and consequences criteria, it may consider conducting research on the extent of potential issues before adding a project to the work plan.

Specific Matter for Comment 4

Do you agree with the projects that the IPSASB proposes to prioritize for addition to the Work Plan 2019–2023 on Theme A: Setting standards on public sector specific issues (*Natural Resources, Discount Rates, Differential Reporting* and *Conceptual Framework limited-scope Review*)? If not please explain your reasoning, and any proposed alternatives.

We agree with adding discount rates and Conceptual Framework limited-scope review to the Work Plan 2019–2023.

The proposed Conceptual Framework limited-scope review covers the evaluation of the IPSAS literature against the Conceptual Framework chapters on elements and recognition but there does not appear to be any evaluation against the chapter on presentation. The Conceptual Framework was issued in 2014. To eliminate any inconsistencies in the IPSAS literature, we recommend the

IPSAS literature is evaluated against the presentation chapter in the Conceptual Framework. The presentation chapter is closely linked to the update to IPSAS 1 *Presentation of Financial Statements* (Theme A) and an equivalent project to the IASB® Initiative—*Better Communication in Financial Reporting* (Theme B). We recommend a project on presentation of financial statements which covers these three elements to be added to the Work Plan 2019–2023. This project would have the benefit of being in both Theme A and Theme B. We are of the view that this project which covers better communication in financial reporting and the update to IPSAS 1 is more prevalent and has more consequences than natural resources and differential reporting. If the information in financial reports is not relevant and not presented in a clear and concise manner, it will be difficult for readers to understand and use this for accountability and decision-making purposes. We note that the public consultation by Eurostat on the *Assessment of the Suitability of the International Public Sector Accounting Standards for the Member States* has criticised IPSAS Standards for the heaviness of rules on disclosures.[1]

Public sector entities are regulated by various legislative instruments in a jurisdiction as well as accounting standards. In the public sector it is important that resources are used economically, efficiently, effectively and as intended. Improving guidance on materiality and disclosures could help reduce the cost of compliance so it is in the public interest for the IPSASB to add this project to its work plan. We have developed an Explanatory Guide A7: *Materiality for Public Benefit Entities*[2] (EG A7). EG A7 provides guidance to public benefit entities[3] in applying materiality to presentation and disclosure when preparing general purpose financial reports. The IPSASB may want to refer to EG A7 if it intends to update its guidance on materiality.

We do not expect the IPSASB to start this project immediately but the first step of adding this to the work plan shows a commitment that it will proceed. To benefit from the IASB's work, the IPSASB could commence its project soon after the IASB has completed its project on *Better Communication in Financial Reporting*.

We do not support adding natural resources and differential reporting to the Work Plan 2019–2023. In New Zealand natural resources is not an issue that is significant enough to warrant specific guidance to be developed.

We envisage a number of challenges in implementing differential reporting at an international level reflective of the various standard-setting bodies and not being in conflict with jurisdictional legislation. The IPSASB would need to establish a framework which identifies what small and medium sized public sector entities should be reporting. For example, will the concessions be for recognition, measurement and disclosures, or for only disclosures? Whilst the IPSASB could develop an IPSAS Differential Reporting model ("the what"), it should be up to each jurisdiction to determine which entities will apply these requirements ("the who").

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1 Eurostat Public consultation – *Assessment of the suitability of the International Public Sector Accounting Standards for the Member States*, Summary of Responses, December 2012.

2 EG A7 can be accessed from: http://www.xrb.govt.nz/accounting-standards/explanatory-guides/

3 Public benefit entities are reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders.

As an alternative to adding a full project on natural resources and differential reporting to its work plan, the IPSASB could first conduct further research on these potential future projects. We encourage the IPSASB to work with academics with an interest in these topics and from jurisdictions where the topic is more pervasive. This approach is not resource intensive for the IPSASB and allows for a better understanding of the key issues and the options available before the IPSASB commits to a formal standard-setting project.

Specific Matter for Comment 5

Do you agree with the project that the IPSASB proposes to prioritise for addition to the Work Plan 2019–2023 on Theme B: Maintaining IFRS convergence (IPSAS 18 *Segment Reporting*)? If not please explain your reasoning, and any proposed alternatives.

The NZASB does not agree with adding the update to IPSAS 18 *Segment Reporting* to the Work Plan 2019–2023. In New Zealand, we have not picked up IPSAS 18 because our legislation has specified that certain public sector entities present service performance information rather than information based on segments. Therefore IPSAS 18 is not relevant for our jurisdiction.

We recommend the IPSASB replaces the project to update IPSAS 18 with an equivalent project to the IASB Initiative—*Better Communication in Financial Reporting,* this project is linked to the update to IPSAS 1. We are of the view that better communication in financial reporting and the update to IPSAS 1 is more prevalent and has more consequences than the update to IPSAS 18. Our reasons for supporting this project is noted in our response to SMC 4.

We fully support projects to maintain convergence with the IASB's narrow scope amendments. In our response to SMC 2, we have provided our reasons for supporting maintaining convergence with IFRS Standards.

Specific Matter for Comment 6

Are there any projects in Appendix A that you believe should be added to the Work Plan 2019–2023 in place of a currently proposed project? If you believe that any Appendix A projects should be added, please explain your views on why the project should be included, which proposed project should not then be started and why.

We recommend the IPSASB add to the Work Plan 2019–2023 a project on the presentation of financial statements that covers evaluating IPSAS literature against the presentation chapter in the Conceptual Framework, update to IPSAS 1 and an equivalent project to the IASB Initiative—*Better Communication in Financial Reporting*. This project is discussed in our response to SMC 4 and SMC 5.

We support the IPSASB carrying out a mid-term work plan consultation in 2020. This would allow the IPSASB to reassess how the current projects are going and if there will be delays with starting new projects. It also provides an opportunity to do an environmental check on emerging issues.

Also refer to our response to SMC 4 and SMC 5 for other projects to be added and removed from the Work Plan 2019–2023.

A project on service performance reporting was not mentioned in Appendix A of the Consultation Document. In 2017 we issued our domestic standard, PBE FRS 48 *Service Performance Reporting.*[4] PBE FRS 48 was issued after extensive consultation with the public sector and NFP sector. In due course if the IPSASB intends to update RPG 3 *Reporting on Service Performance Information*, the IPSASB may want to refer to PBE FRS 48 for guidance.

Specific Matter for Comment 7

The IPSASB views building relationships with those working in the PFM space and engaging in their work as critical to furthering the use of IPSAS in PFM reform projects. Therefore, under Themes D and E, the IPSASB will actively monitor the work of others and look for appropriate opportunities to engage and support that work.

- Do you agree with the IPSASB's proposed approach under these Themes? If so, are you aware of any ongoing initiatives which the IPSASB should monitor and look to engage with (please provide details).
- If you do not agree, please explain your reasoning along with any proposed alternatives, and how those might be resourced.

We agree with the IPSASB's proposed approach under Themes D and E. The IPSASB has limited resources so cannot do everything. In order for the IPSASB to meet its strategic objective, more jurisdictions need to adopt accrual-based IPSAS. This would result in more constituent input and would eventually lead to better quality IPSAS guidance.

We agree with the IPSASB to continue supporting the implementation of new IPSAS in the form of the *At a Glance* publications and webinars. This has been helpful to encourage submissions on due process documents and to promote awareness of new standards and guidance issued by the IPSASB. We support the IPSASB to continue developing examples in standards and other guidance to promote consistent application of new IPSAS literature.

We recommend that the IPSASB provides more support when new standards are issued. The IPSASB cannot expect preparers to apply a standard without some assistance with implementation. This is particularly important for public sector specific standards where there is no IFRS Standard for reference. An example is the accounting for amalgamations in IPSAS 40 *Public Sector Combinations*.[5] The IASB is providing a wide range of support materials for new IFRS Standards, these include articles, podcasts, and the ability to submit to the Transition Resource Groups. The IPSASB may want to consider providing similar types of support for significant new standards expected to be issued and will become effective over the 2019–2023 period.

As more jurisdictions adopt IPSAS Standards, there is likely to be an increased demand for interpretation support, we therefore encourage the IPSASB to consider introducing an interpretative function in the future, which fulfils a similar role to the IFRS Interpretations Committee.

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[4] PBE FRS 48 can be accessed from: http://www.xrb.govt.nz/accounting-standards/not-for-profit/pbe-frs-48/

[5] We acknowledge the IPSASB has recently developed a webinar on IPSAS 40 *Public Sector Combinations* Presentation of Amalgamation.

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	20 April 2018
To:	NZASB Members
From:	Joanne Scott
Subject:	**Conceptual Framework**

Recommendations[1]

1. We recommend that the Board:

   (a) APPROVES the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* (2018 *NZ Conceptual Framework*) for issue as an authoritative notice (see agenda item 8.3);[2]

   (b) APPROVES *Amendments to References to the Conceptual Framework in NZ IFRS* for issue as an amending standard (see agenda items 8.2 and 8.4); and

   (c) APPROVES the signing memorandum from the Chair of the NZASB to the Chair of the XRB Board requesting approval to issue the authoritative notice and amending standard (see agenda item 8.5).

2. The amending standard includes some New Zealand-specific amendments. There is a separate memo seeking agreement to these amendments (see agenda item 8.2).

Introduction

3. The IASB issued the *Conceptual Framework for Financial Reporting* (2018 *Conceptual Framework*) on 30 March 2018. The IASB has also issued an amending standard which updates references to conceptual frameworks in IFRS Standards. In accordance with the Accounting Standards Framework we are now seeking the Board's approval of the New Zealand equivalents to these pronouncements.

4. This memo explains how the IASB's project progressed over time and how the IASB has dealt with key issues, including those that the NZASB commented on.

[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).

[2] The functions of the External Reporting Board (as per section 12 of the Financial Reporting Act 2013) include issuing standards and, for the purposes of the definition of generally accepted accounting practice, issuing authoritative notices. Because the 2018 *NZ Conceptual Framework* is not a standard it is issued as an authoritative notice.

5. This memo is structured as follows:

   (a) Background;

   (b) Key issues;

   (c) RDR concessions and consistency with Australian pronouncements;

   (d) Due process;

   (e) Approval sought; and

   (f) IASB and IPSASB frameworks.

Background

6. The following diagram shows how this project has progressed over time and the due process documents associated with the project.

2004–2010 Joint IASB FASB project	Conceptual Framework (2010)	2012–2018 IASB only project	Conceptual Framework (2018)
2006 DP Objective, QCs 2008 ED Objective, QCs 2010 ED Reporting entity	Chapters 1 to 4 (but only two new chapters) Limited updating of references	ED/2015/3 Conceptual Framework ED/2015/4 Updating References	Chapters 1 to 8 Amendments to References to the Conceptual Framework in IFRS Standards

7. For those Board members that would like more detail about how the project unfolded, we have included a number of appendices. They are:

   (a) Appendix 1: History of New Zealand frameworks;

   (b) Appendix 2: Phases of joint IASB-FASB project;

   (c) Appendix 3: NZASB's comments on the 2015 EDs (and the related IASB discussions and decisions);

   (d) Appendix 4: IASB and ASAF meetings; and

   (e) Appendix 5: IASB and IPSASB frameworks.

8. These appendices are not essential reading but they indicate what the issues were, and which issues took the longest to resolve. Appendix 3 is likely to be of most interest. We have also included the IASB's project summary and feedback statement in the supporting papers (see agenda items 8.6 and 8.7).

Joint IASB FASB project

9. In October 2004 the IASB and Financial Accounting Standards Board (FASB) agreed to undertake a joint project to develop a common conceptual framework. The initial work was conducted in phases.[3]

10. The first phase addressed objectives and qualitative characteristics. This work led the IASB to issue a revised conceptual framework in September 2010. The *Conceptual Framework for Financial Reporting* (2010 *Conceptual Framework*) had four chapters.

    (a) Chapter 1 The objective of general purpose financial reporting. This chapter was new.

    (b) Chapter 2 The reporting entity. This chapter was blank. It was a placeholder for the work on the reporting entity concept, which was still under development.

    (c) Chapter 3 Qualitative characteristics of useful financial information. This chapter was new. It replaced the previous qualitative characteristics with two fundamental characteristics (relevance and faithful representation) and some enhancing characteristics.

    (d) Chapter 4 The Framework (1989). This chapter contained the remaining text of the *Framework for the Preparation and Presentation of Financial Statements* (1989).

11. The Financial Reporting Standards Board (FRSB) decided to limit the application of the 2010 *Conceptual Framework* to for-profit entities.[4] The FRSB gave effect to this decision by issuing the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting 2010* (NZ *Framework*) as a two-part document: Part A (the 2010 *Conceptual Framework*) applied to for-profit entities; and Part B (the New Zealand equivalent to the IASC's 1989 framework) applied to public benefit entities. In February 2011 the Accounting Standards Review Board gave a direction under the Financial Reporting Act 1993 that the NZ *Framework* had authoritative support. The FRSB also made limited amendments to standards to update references to the framework documents.

12. Work on the conceptual framework project slowed in 2010, due in part to the demands of other major projects. In late 2010 the joint project ceased and the IASB decided to defer the project so it could complete some other priority projects. During the IASB's 2011 agenda consultation many respondents asked the IASB to reactivate and finalise the conceptual framework project. The IASB recommenced work on the project in September 2012, as an IASB-only project.

IASB-only project

13. When the IASB recommenced work on the conceptual framework project in 2012 it did a stocktake of where the project was at and considered how it could move forward.

[3] If Board members would like further detail, please refer to Appendix 2 of this memo.

[4] The FRSB adopted this approach because of impending changes to the financial reporting framework in New Zealand and because the IASB had indicated that it would consider not-for-profit issues in Phase G of the project. Both of these factors created some uncertainty about how the FRSB should deal with PBE issues. Phase G of the project was never completed.

14. In July 2013 the IASB issued a Discussion Paper entitled DP/2013/1 *A Review of the Conceptual Framework for Financial Reporting* which outlined the IASB's intention to complete the project in a single phase and sought feedback on the areas on which it should focus. In addition to commenting on the specific questions in this DP, the NZASB said that the IASB should take more time to develop the following fundamental areas:

    (a) the meaning of 'financial performance';

    (b) the distinction between profit or loss and other comprehensive income (OCI);

    (c) the meaning of 'present obligation';

    (d) recognition criteria (and how to deal with uncertainty);

    (e) measurement; and

    (f) presentation and disclosure.

15. The NZASB also said that without further work on these areas any revised framework would not be a sufficient improvement on the 2010 *Conceptual Framework*.

16. In May 2015 the IASB issued:

    (a) ED/2015/3 *Conceptual Framework for Financial Reporting*; and

    (b) ED/2015/4 *Updating References to the Conceptual Framework* (Proposed amendments to IFRS 2, IFRS 3, IFRS 4, IFRS 6, IAS 1, IAS 8, IAS 34, SIC-27 and SIC-32).

17. The NZASB commented to the IASB on both exposure drafts in November 2015 (see agenda item 8.8 in the supporting papers).

<u>2015–2018</u>

18. The IASB conducted more than 80 outreach meetings on the exposure drafts and received 233 comment letters. The NZASB's comment letter on ED/2015/3 (see agenda item 8.8 and Appendix 3 of this memo) expressed the view that the following topics required further development:

    (a) the definition of a liability;

    (b) the chapter on measurement; and

    (c) the meaning of 'financial performance' and the distinction between profit or loss and OCI.

19. The AASB's comment letter identified similar matters as areas of key concern. The IASB spent over two years considering the comments received, deciding how to respond and finalising the text.[5] During that time the IASB also sought feedback from groups such as the Accounting Standards Advisory Forum (ASAF) on how it should proceed in relation to certain issues. IASB staff later thanked ASAF members for their contribution to the project.

[5] If Board members would like further detail about when topics were redeliberated, please refer to Appendix 4 to this memo.

20. Deliberations took longer than expected and required some pragmatic decisions about what the IASB could and could not achieve in a realistic timeframe. Early in 2017 an IASB staff paper described the IASB's approach to the project as follows "The Board aims to make significant improvements to the Conceptual Framework without delay and expects to complete the revisions to the Conceptual Framework in 2017. To achieve this, the Board is building on the existing Conceptual Framework—updating it, improving it and filling in gaps instead of fundamentally reconsidering all aspects of the Conceptual Framework." Effectively this meant that the IASB had to decide which parts it could improve and finalise in the immediate future and which parts needed to be considered as part of future projects.

21. The IASB kept constituents informed about its deliberations. In July 2017 the IASB issued *Summary of tentative decisions on the Conceptual Framework for Financial Reporting* which reflected the IASB's tentative decisions as at 21 March 2017. In October 2017 it issued an updated version of that document. In March 2018 it issued a *Feedback Statement*.

<u>Conceptual Framework for Financial Reporting</u>

22. The IASB issued the 2018 *Conceptual Framework* on 30 March 2018. The IASB has announced that it and the IFRS Interpretations Committee will begin using the revised framework immediately. However, the issue of the 2018 *Conceptual Framework* will not automatically lead to changes in existing standards. The IASB will consider the impact of the revised *Conceptual Framework* on existing standards as it revises those standards. The 2018 *Conceptual Framework* contains a section on the status and purpose of the 2018 *Conceptual Framework* which acknowledges the role of the 2018 *Conceptual Framework* for parties other than the IASB.

23. The 2018 *Conceptual Framework* contains eight chapters.

    Chapter 1—The objective of general purpose financial reporting
    Chapter 2—Qualitative characteristics of useful financial information
    Chapter 3—Financial statements and the reporting entity
    Chapter 4—The elements of financial statements
    Chapter 5—Recognition and derecognition
    Chapter 6—Measurement
    Chapter 7—Presentation and disclosure
    Chapter 8—Concepts of capital and capital maintenance

24. The IASB's Project Summary (see agenda item 8.6 in the supporting papers) summarises the changes between the 2010 and 2018 frameworks. It is difficult to assess the impact of these changes as a revised framework shapes the development of future standards and existing standards as and when those standards are revised. Some areas where the 2018 *Conceptual Framework* differs from the 2010 *Conceptual Framework* are as follows.

    (a) The definition of an asset: Both the 2018 and 2010 frameworks refer to assets as resources, but the revised framework goes on to say that "an economic resource is a right that has the potential to produce economic benefits." Some assets that are currently recognised as a single item could be viewed as a collection of rights but the implications of this for standards are unknown.

(b) The definition of a liability: Both the 2018 and 2010 frameworks refer to liabilities as obligations, but the revised framework now says that "An obligation is a duty or responsibility that an entity has no practical ability to avoid." The implications of this statement have been subject to much debate.

(c) The recognition of assets and liabilities: The 2010 *Conceptual Framework* has recognition criteria for assets and liabilities – the inflows or outflows must be probable and able to be measured reliably. The 2018 *Conceptual Framework* does not include these recognition criteria. Instead, the section on recognition criteria draws heavily on the two fundamental qualitative characteristics (relevance and faithful representation) and the discussion of relevance acknowledges that uncertainty over existence and a low probability of inflows or outflows might mean that an item should not be recognised.

(d) The 2010 *Conceptual Framework* did not define derecognition; nor did it describe when derecognition occurs. The 2018 *Conceptual Framework* has a section on derecognition which states that derecognition normally occurs when an item no longer meets the definition of an asset or of a liability, discusses faithful representation in relation to derecognition and considers issues associated with partial derecognition of items.

(e) Measurement: The 2010 *Conceptual Framework* included little guidance on measurement. Chapter 6 describes various measurement bases, the information they provide and factors to consider when selecting a measurement basis.

25. Although some commentators have suggested that these are areas where the 2018 *Conceptual Framework* could lead to change, the IASB has said (in its Feedback Statement) that it does not expect the combined effect of the definitions and recognition criteria to either broaden or narrow the range of items recognised.

<u>Amendments to References to the Conceptual Framework in IFRS Standards</u>

26. The 2018 *Conceptual Framework* is accompanied by an amending standard which updates references to previous frameworks in IFRS Standards.[6] These updated references are effective for annual periods beginning on or after 1 January 2020. Early application is permitted. Retrospective application is required unless this would be impracticable or cause undue cost or effort.

27. In most cases, the references in standards are updated to refer to the 2018 *Conceptual Framework*. In the case of IFRS 3 *Business Combinations* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (in relation to developing accounting policies for regulatory account balances) the IASB has chosen not to update the references at this time. In those instances preparers must continue to apply the definitions of an asset and a liability (and supporting concepts) in the 2010 *Conceptual Framework.*

[6] The IASB issued the amending standard in three parts: Part A amends IFRS Standards; Part B amends non-integral examples, guidance and practice statements; and Part C amends bases for conclusions. We will issue Part A as the New Zealand amending standard and make the other amendments available to constituents as additional material.

(a) In the case of IFRS 3 the IASB recognised that applying the revised definitions would change which assets and liabilities would qualify for recognition in a business combination. In some such cases, the post-acquisition accounting required by other IFRS Standards could then lead to immediate derecognition of assets or liabilities recognised in a business combination, resulting in so-called *Day 2 gains or losses* that do not depict an economic gain or loss. The IASB plans to do further work on this issue and to amend IFRS 3 in a way that does not cause unintended consequences.

(b) In the case of IAS 8 the IASB wanted to avoid entities having to change accounting policies for regulatory account balances twice – once for the revised *Conceptual Framework* and then again when a revised standard on rate-regulated activities is issued.

28. The IASB will consider the impact of the revised definitions of assets and liabilities as it revises standards. Therefore, some standards will continue to refer to the previous definitions. IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (paragraph 10) will continue to use an earlier definition of a liability and IAS 38 *Intangible Assets* (paragraph 8) will continue to use an earlier definition of an asset.

29. Because some standards will continue to refer to earlier definitions and frameworks we do not plan to withdraw the 2010 NZ *Conceptual Framework* at this time. We discuss this issue in more detail later in this memo.

Key issues

30. This section of the memo focuses on the key issues identified by the NZASB in its comments on the 2015 EDs (see agenda item 8.8 and Appendix 3 of this memo). The NZASB expressed the view that the following topics required further development:

(a) the definition of a liability (particularly the description of a present obligation);

(b) the meaning of 'financial performance' and the distinction between profit or loss and OCI; and

(c) the chapter on measurement.

31. The AASB also identified these matters as areas of key concern.

<u>Definition of a liability and present obligations</u>

32. The 2015 ED proposed that an entity has a present obligation to transfer an economic resource if both:

(a) the entity has no practical ability to avoid the transfer; and

(b) the obligation has arisen from past events; in other words, the entity has received the economic benefits, or conducted the activities, that establish the extent of its obligation.

33. The ED proposed additional guidance on the meaning of the phrase 'no practical ability to avoid'. The Basis for Conclusions on the ED stated that the proposed description of a present

obligation would help to resolve questions about whether 'economic compulsion' is sufficient to create a liability. Relevant extracts from the 2015 ED follow.

Extracts from the 2015 ED

Present obligation

4.31 An entity has a present obligation to transfer an economic resource if both:

(a) the entity has no practical ability to avoid the transfer; and

(b) the obligation has arisen from past events; in other words, the entity has received the economic benefits, or conducted the activities, that establish the extent of its obligation.

No practical ability to avoid the transfer

4.32 An entity has no practical ability to avoid a transfer if, for example, the transfer is legally enforceable, or any action necessary to avoid the transfer would cause significant business disruption or would have economic consequences significantly more adverse than the transfer itself. It is not sufficient that the management of the entity intends to make the transfer or that the transfer is probable.

BC4.75 The IASB thinks that [the two criteria specified in the description of a present obligation] make it clear that:

(a) economic compulsion may be a factor that reduces the entity's practical ability to avoid a future transfer—so it would need to be considered in assessing whether that criterion is met; but

(b) economic compulsion on its own cannot create a present obligation—there is also the requirement for the obligation to have arisen from a past event (receiving economic benefits, or conducting activities, that establish the extent of the entity's obligation).

34. The NZASB's 2015 comment letter expressed concerns that, despite it not being the IASB's intention, there was a risk that the proposed description of a present obligation and accompanying guidance would capture too many items, including some future costs, as liabilities.

35. Although the IASB agreed to try to refine the description of a present obligation and the meaning of 'no practical ability to avoid', this matter continued to be the subject of debate throughout the project. In July 2017 IASB sought feedback from IASB members and selected reviewers on proposed text. Several reviewers suggested that, taken together, some of the paragraphs in the proposed text would lead to a conclusion that an entity has a present obligation for all future costs (into perpetuity) that it will have no practical ability to avoid as a going concern. Such costs could include payments required to maintain future production capacity (for example, salaries or repairs and maintenance), future losses and future years' taxes and levies.

36. The IASB acknowledged these concerns but kept the criterion of 'no practical ability to avoid'. The Basis for Conclusions states that "the Board noted that preparers of financial statements will rarely be required to apply that criterion without further requirements and guidance. The Board will, if necessary, develop guidance on applying that criterion to particular cases as it develops Standards." The NZASB is likely to have an ongoing interest in any issues that arise from the application of this new definition.

Financial performance and OCI

37. The 2015 ED contained some rebuttable presumptions about when revenue and expense should be included in OCI and recycling. It proposed that income or expenses could be reported outside the statement of profit or loss and in OCI only if:

    (a) the income or expenses relate to assets or liabilities measured at current values; and

    (b) excluding those items from the statement of profit or loss would enhance the relevance of the information in the statement of profit or loss for the period.

38. It also proposed that items included in OCI in one period would be recycled into profit or loss in the future if doing so would enhance the relevance of the future statements and identified some situations in which this presumption could be rebutted.

39. The NZASB felt that the 2015 ED was unclear about what profit or loss is intended to represent and the role of OCI in enhancing the relevance of profit or loss. Given the lack of an existing conceptual basis for OCI and the diversity of views on this matter, the NZASB suggested that the IASB undertake further work on these issues. The NZASB suggested that the IASB avoid setting requirements in the *Conceptual Framework* that might inadvertently or unnecessarily prevent the future evolution of accounting.

40. The IASB has softened the original proposals slightly (see paragraph 7.19 below).

Extract from 2018 Conceptual Framework

7.19 In principle, income and expenses included in other comprehensive income in one period are reclassified from other comprehensive income into the statement of profit or loss in a future period when doing so results in the statement of profit or loss providing more relevant information, or providing a more faithful representation of the entity's financial performance for that future period. However, if, for example, there is no clear basis for identifying the period in which reclassification would have that result, or the amount that should be reclassified, the Board may, in developing Standards, decide that income and expenses included in other comprehensive income are not to be subsequently reclassified.

Measurement

41. The 2015 ED discussed measurement bases under the headings of historical cost and current value (fair value; and value in use (for assets) and fulfilment value (for liabilities)). It identified factors to consider when selecting a measurement base and contemplated the possibility of using more than one measurement base to measure an item in different statements.

42. The NZASB commented extensively on this section of the 2015 ED. Other respondents also commented extensively on this section of the 2015 ED. However, they had mixed views and there was no straightforward way of addressing all respondents' concerns. The IASB worked on revisions to this chapter throughout 2016 and 2017. Points made by the NZASB and the IASB's final position in the 2018 *Conceptual Framework* are set out in Table 1.

Table 1

NZASB comments on 2015 ED	**2018 *Conceptual Framework***
The objective of the [draft] chapter and the intended users were unclear. The [draft] chapter was more a description of current practice than an explanation of the conceptual basis for various measurement bases. The NZASB encouraged the IASB to develop an overall measurement objective.	No separate measurement objective. Describes how measurement contributes to the objective of general purpose financial statements (see paragraph 6.45).
The NZASB had concerns about how measurement bases were categorised. The NZASB encouraged the IASB to consider using entry-exit and entity-specific or non-entity-specific attributes as a way of classifying measurement bases.	The IASB considered and rejected this suggestion. The Board did not find such a distinction useful when describing or selecting a measurement basis for use in a particular Standard because the difference between entry and exit values in the same market is often small, except for transaction costs.
The NZASB considered that the proposed guidance on selection of a measurement base was too simplistic and that there was too much emphasis on measurement uncertainty as a factor influencing the selection of a measurement basis.	Chapter 2 still discusses measurement uncertainty as a factor that can affect how well information meets the qualitative characteristics (paragraph 2.22). Measurement uncertainty is discussed in the context of faithful representation rather than relevance. See also paragraphs 6.60 to 6.62.
The NZASB was opposed to split measurement (being the use of different measurement bases in different statements with the balancing amounts being taken to OCI).	Chapter 6 still envisages the possibility of split measurement (see paragraphs 6.83 to 6.86). Chapter 7 refers to the possibility of taking changes in value to OCI *in exceptional circumstances* (see paragraph 7.17).

<u>Ongoing projects</u>

43. Some issues discussed during the development of the 2018 *Conceptual Framework* will be considered further in other projects.

    (a) The Conceptual Framework project did not develop concepts to address challenges that arise in classifying financial instruments with characteristics of both liabilities and equity. The IASB has a project on Financial Instruments with Characteristics of Equity which is exploring whether the IASB can improve the existing requirements in IAS 32 *Financial Instruments: Presentation* for classifying such financial instruments. The project will also look at presentation and disclosure requirements. The IASB expects to publish a Discussion Paper on this topic later this year.

    (b) The IASB is continuing work on the presentation of income and expenses and OCI in its project on Primary Financial Statements. The IASB is exploring targeted improvements to the structure and content of the primary financial statements, with a focus on the statement(s) of financial performance. The IASB expects to publish a Discussion Paper on this topic later this year.

RDR concessions and consistency with Australian pronouncements

44. The 2018 *NZ Conceptual Framework* does not establish disclosure requirements and does not discuss the Reduced Disclosure Regime (RDR). The amending standard does not create or substantively amend any disclosure requirements, so it does not give rise to any RDR considerations.

45. To maintain compliance with IFRS Standards for publicly accountable for-profit entities (such as listed and disclosing entities) required to prepare financial statements in accordance with Australian Accounting Standards and other entities voluntarily preparing tier 1 general purpose financial statements (GPFS), the AASB proposes making the IASB's revised *Conceptual Framework* available to these entities later this year. The AASB intends to seek feedback on this approach via a Consultation Paper with a one-month consultation period (short-term approach).

46. The AASB also intends in the medium term (medium-term approach), to make the IASB's revised *Conceptual Framework* applicable to all other entities required to prepare financial statements in accordance with Australian Accounting Standards. However, making the IASB's revised *Conceptual Framework* applicable to all entities required to prepare financial statements in accordance with Australian Accounting Standards would have important consequences for some entities. This is because currently, entities in Australia that are required to prepare financial statements in accordance with the Australian Accounting Standards, apply the definition of 'reporting entity' in Statement of Accounting Concepts 1 (SAC 1) *Definition of the Reporting Entity*, AASB 1053 *Application of Tiers of Australian Accounting Standards* and AASB 1057 *Application of Australian Accounting Standards* to determine whether they are reporting entities, i.e. have users who depend on GPFS to make decisions. Entities that have self-assessed as reporting entities would prepare GPFS and entities that have self-assessed as non-reporting entities have the option to prepare special purpose financial statements (SPFS).

47. The use of the term 'reporting entity' in SAC 1, AASB 1053 and AASB 1057 is not consistent with how the term 'reporting entity' is used in the IASB's revised *Conceptual Framework*. As such, when the IASB's revised *Conceptual Framework* is made applicable to all entities preparing financial statements in accordance with Australian Accounting Standards, the use of the term 'reporting entity' in SAC 1 and Australian Accounting Standards would have to be removed, effectively removing the option for entities to prepare SPFS, if they are required to comply with Australian Accounting Standards. As this would be a major change for some entities, the AASB intends to consult extensively on its medium-term approach (three-month consultation period), and is including proposals on an alternative tier 2 reporting framework (that could replace the current tier 2 requirements – RDR).

Due process

48. Following its consideration of comments from constituents, the IASB reviewed the due process steps that it had taken since the publication of ED/2015/3 and ED/2015/4 and concluded that the applicable due process steps for the new framework and the amending standard had been completed. This review of due process occurred at the IASB's meetings in February and March 2017.[7]

49. The due process undertaken by the NZASB in respect of these EDs was as follows.

    (a) The NZASB issued the EDs for comment in New Zealand. Comments were due to the NZASB on 9 October 2015 and to the IASB on 26 October 2015.

    (b) The NZASB received two comment letters on the conceptual framework (ED/2015/3) and one comment letter on the proposed amending standard (ED/2015/4) (see agenda item 2.3). One of the comment letters came from an international constituent who also commented to the IASB and the AASB – that constituent did not clearly express support or disagreement with any specific proposals. The other constituent was generally supportive of the proposals in the EDs but commented on a few matters that were also addressed in the NZASB's comment letter to the IASB (such as elaborating further on the concepts of stewardship and prudence and noting the difficulty of applying the proposed definition of a liability).

50. The IASB received 233 comment letters including letters from the NZASB, the AASB and the Australia and New Zealand Banking Group Limited (ANZ).

51. Subject to the Board's agreement to the additional New Zealand-specific amendments discussed in agenda item 8.2, we consider that the due process followed by the NZASB complied with the due process requirements established by the XRB Board and meets the requirements of section 22 of the Financial Reporting Act 2013.

52. In accordance with section 22(2) of the Financial Reporting Act 2013 we have considered whether the 2018 *NZ Conceptual Framework* and the amending standard are likely to require the disclosure of personal information. In our view the 2018 *NZ Conceptual Framework* and the amending standard do not include requirements that would result in the disclosure of personal information and therefore no consultation with the Privacy Commissioner is required.

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[7] The IASB's February 2017 Agenda Paper 10F *Due process summary for the Conceptual Framework for Financial Reporting* is available at: http://www.ifrs.org/Meetings/Pages/IASB-Meeting-February-2017.aspx.
The IASB's March 2017 Agenda Paper 10C *Due process summary for References to the Conceptual Framework* is available at: http://www.ifrs.org/Meetings/Pages/IASB-Meeting-March-2017.aspx.
The IASB Updates for February and March 2017 are available at:
https://s3.amazonaws.com/ifrswebcontent/2017/IASB/February/IASB-February-Update-2017.pdf and
http://www.ifrs.org/-/media/feature/news/updates/iasb/2017/iasb-update-mar-2017.pdf

Approvals sought

53. We are seeking approval of:

    (a) the 2018 *NZ Conceptual Framework* for issue as an authoritative notice, effective from 1 January 2020;

    (b) *Amendments to References to the Conceptual Framework in NZ IFRS* for issue, effective from 1 January 2020; and

    (c) the draft certificate signing memorandum from the Chair of the NZASB to the Chair of the XRB Board.

54. We have aligned the effective date of the 2018 *NZ Conceptual Framework* with that of the amending standard. Although the IASB has not given the 2018 *Conceptual Framework* an effective date we are required to give an authoritative notice an effective date.

55. As discussed earlier we will not supersede the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting 2010* until the IASB has addressed some references to earlier frameworks in a couple of standards. In order to avoid confusion we propose to:

    (a) refer to the new framework as the 2018 *NZ Conceptual Framework*; and

    (b) place a text box on the front cover of the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting 2010* explaining the status of that document (see draft text below).

> **The 2018 *NZ Conceptual Framework* (issued May 2018) is effective for annual periods beginning on or after 1 January 2020. From the point at which the 2018 *NZ Conceptual Framework* becomes effective, entities will refer to this NZ *Framework* in the limited circumstances that they are required to do so by the relevant NZ IFRS.**

> **Questions for the Board**
>
> Q1 Does the Board approve the issue of the 2018 *NZ Conceptual Framework*?
>
> Q2 Does the Board approve the issue of *Amendments to References to the Conceptual Framework in NZ IFRS?*
>
> Q3 Does the Board approve the draft certificate signing memorandum?
>
> Q4 Does the Board agree with the proposed text box for the front cover of the previous NZ *Framework*?

IASB and IPSASB frameworks

56. We note that the IPSASB has indicated that it might undertake a limited scope review of its conceptual framework (see extract from the IPSASB *Proposed Strategy and Work Plan 2019–2023* below) and will monitor developments.[8]

> **Extract from IPSASB *Proposed Strategy and Work Plan 2019–2023***
>
> The IPSASB developed its own Conceptual Framework as the primary basis for its future standard setting activities. In finalizing its Framework in September 2014, it drew on relevant parts of the IASB's Framework at that point. The impending revisions to the IASB's Framework have therefore increasingly raised questions about whether the relevant aspects of the IPSASB's own Conceptual Framework should be revised. This project would therefore evaluate the changes made to the IASB's Conceptual Framework, and their relevance to the public sector. Linked to this work, the IPSASB also proposes to evaluate the need for changes to its literature in light of the IPSASB Conceptual Framework chapters on Elements and Recognition in Financial Statements.

Attachments

Agenda item 8.2:	Memo on New Zealand-specific amendments
Agenda item 8.3:	Draft New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* issued in 2018 (2018 *NZ Conceptual Framework*)
Agenda item 8.4:	Draft *Amendments to References to the Conceptual Framework in NZ IFRS*
Agenda item 8.5:	Draft signing memorandum
Agenda item 8.6:	IFRS Conceptual Framework: Project Summary (in supporting papers)
Agenda item 8.7:	IFRS Conceptual Framework: Feedback Statement (in supporting papers)
Agenda item 8.8:	NZASB comment letter (2015) (in supporting papers)
Agenda item 2.3:	Comment letters from constituents (2015)

[8] If Board members would like further detail on the differences between these frameworks, Appendix 5 of this memo contains a high-level comparison.

Appendices

Appendix 1: History of New Zealand frameworks

Appendix 2: Phases of joint IASB-FASB project

Appendix 3: NZASB's comments on the 2015 EDs

Appendix 4: IASB and ASAF meetings

Appendix 5: IASB and IPSASB frameworks

Appendix 1 History of New Zealand frameworks

This Appendix lists the conceptual frameworks in New Zealand since 1993 and the equivalent IASB frameworks.

New Zealand Frameworks	**IASB Frameworks**
Statement of Concepts for General Purpose Financial Reporting issued in 1993 by the New Zealand Society of Accountants.	–
New Zealand Equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements* issued in April 2005 by the FRSB, ICANZ.[9] It included some New Zealand specific guidance for PBEs.	*Framework for the Preparation and Presentation of Financial Statements* issued in 1989
New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting 2010* (NZ *Framework*) (February 2011) issued by the FRSB, NZICA. It had two parts: • Part A: for profit-oriented entities • Part B: for public benefit entities	*Conceptual Framework for Financial Reporting* issued in 2010
Public Benefit Entities' Framework (*PBE Framework*) issued as an authoritative notice in 2013. This was previously Part B of the NZ *Framework* – it was separated and issued as a separate framework.	
Following changes to the Financial Reporting Act, in March 2014 the existing frameworks were reissued. Between 2012 and 2014 there were some temporary frameworks issued for suites of standards that were subsequently withdrawn.	The for-profit NZ Frameworks over this period were equivalent to the IASB's *Conceptual Framework for Financial Reporting* issued in 2010.
Public Benefit Entities' Conceptual Framework issued as an authoritative notice in May 2016. This framework is closely based on the IPSASB *Conceptual Framework*.	
New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* issued in 2018 (2018 *NZ Conceptual Framework*) – approval to issue is being sought in May 2018.	*Conceptual Framework for Financial Reporting* issued in 2018

9 The Accounting Standards Review Board (ASRB) directed that the new framework be designated as authoritative support for the accounting profession in New Zealand.

Appendix 2 Phases of joint IASB-FASB project

This table shows the planned phases in the joint IASB-FASB project and how work on these phases progressed. More information is available in documents issued by the IASB.

Phase	**What happened?**
Phase A: Objectives and qualitative characteristics	In July 2006 the IASB and the FASB issued a Discussion Paper, *Preliminary Views on an improved Conceptual Framework for financial reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information.* The IASB and FASB issued an ED in May 2008. The title of the ED was *An improved Conceptual Framework for Financial Reporting: Chapter 1: The Objective of Financial reporting and Chapter 2: Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information.* Most of the work on this phase was completed in 2010 and issued as Chapters 1 and 3 of the 2010 *Conceptual Framework*. In finalising the 2018 *Conceptual Framework* the IASB: • added a discussion of stewardship to Chapter 1; • renamed Chapter 3 as Chapter 2; and • reintroduced the concept of prudence in Chapter 2.
Phase B: Elements and recognition	Although the IASB and FASB worked together on these topics they did not issue any due process documents. The IASB recommenced work in 2012 and issued proposals in ED/2015/3. The work on these topics was finalised in Chapters 3 and 5 of the 2018 *Conceptual Framework*.
Phase C: Measurement	Although the IASB and FASB worked together on this topic they did not issue any due process documents. The IASB recommenced work on this topic in 2012 and issued proposals in ED/2015/3. A number of respondents were of the view that the IASB needed to do more work on measurement. Some, such as the NZASB, were concerned that rewriting the measurement chapter could delay the completion of the project. The 2018 *Conceptual Framework* discusses measurement bases and factors that will help the Board to develop measurement requirements in Standards. It does not specify definitively when a particular measurement basis would be appropriate. The discussion of concepts of capital and capital maintenance in Chapter 8 was carried forward from the 2010 *Conceptual Framework*.
Phase D: Reporting entity	In March 2010 the IASB and FASB issued ED/2010/2 *Conceptual Framework for Financial Reporting – The Reporting Entity*. The IASB and FASB considered feedback on this ED but shortly afterwards (in late 2010) the joint project stopped. The IASB recommenced work on this topic in 2012 and issued proposals in ED/2015/3. The work on this topic was finalised in Chapter 3 of the 2018 *Conceptual Framework*.
Phase E: Presentation and disclosure	The IASB and FASB did not issue any joint due process documents on this phase. The IASB recommenced work on this topic in 2012 and issued proposals in ED/2015/3. The work on this topic was finalised in Chapter 7 of the 2018 *Conceptual Framework*.

Phase	**What happened?**
Phase F: Purpose and status	One of the objectives of this phase was to reach a converged IASB-FASB view on the secondary purpose of the framework to assist preparers in preparing financial statements (which is not present in US GAAP). Work on this phase was discontinued in 2010.
Phase G: Application to not-for-profit entities	The IASB and FASB initially planned to address not-for-profit and public sector entities toward the end of the project. This phase was not initiated.
Phase H: Remaining issues	This phase was intended to consider any residual issues after completion of the other phases. It was not required as the IASB completed all phases together.

Appendix 3 NZASB's comments on the 2015 EDs

This Appendix summarises the NZASB's comments on ED/IASB/3 and ED/IASB/4 and the final position taken by the IASB.

NZASB's views (Nov 2015)[10]	IASB discussions and decisions[11]
Chapters 1 and 2—The objective of general purpose financial reporting and the qualitative characteristics of useful financial information	
Q1(a) Assessing stewardship • NZASB supported giving more prominence to stewardship. • NZASB expressed concern that some might regard this as a preference for historical cost.	May 2016 The IASB agreed to: • clarify the link between stewardship and resource allocation decisions (see, for example, paragraph 1.2); and • indicate that increasing the prominence of stewardship in Chapter 1 does not imply a preference for any particular measurement basis (paragraph BC 1.40).
Q1(b) Reintroduction of prudence • NZASB disagreed with proposals. • NZASB noted dangers of misinterpretation and misapplication. Risk of bias and inconsistent application. • NZASB highlighted the need for neutrality. Cautioned against an asymmetric notion of prudence.	May, September and October 2016 • The IASB reintroduced prudence. "Neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgements under conditions of uncertainty." (paragraph 2.16) • The IASB rejected requests for asymmetric prudence to be identified as a necessary qualitative characteristic (paragraph BC2.41).
Q1(c) Faithful representation represents substance over form • NZASB supported proposals.	May 2016 • Confirmed (paragraph 2.12).
Q1(d) Measurement uncertainty is one factor that can make financial information less relevant • NZASB disagreed with discussing measurement uncertainty in relation to relevance and said that it should be linked to faithful representation. • Concerns about discussion of faithful representation (ED, paragraph 2.19 and 2.20).	May 2016 and September 2017 • The IASB agreed with the first point. The 2018 *Conceptual Framework* explains that measurement uncertainty is one factor that can affect the possibility of providing a faithful representation, and that in some cases there could be a trade-off between relevance and faithful representation (paragraph 2.22). • The IASB kept paragraph 2.19 (now 2.18) but added paragraph 2.19 which explains that the use of estimates is an essential part of the preparation of financial statements. • The IASB kept the first two sentences in paragraph 2.20 (still 2.20) but deleted the last two sentences.

10 Paragraph references in this column are to the exposure drafts.

11 Paragraph references in this column are to the 2018 *Conceptual Framework*. Date references are to the IASB meetings at which these matters were considered.

NZASB's views (Nov 2015)[10]	**IASB discussions and decisions**[11]
Q1(e) Relevance and faithful representation as fundamental qualitative characteristics • NZASB supported proposals. • Do not reintroduce reliability as qualitative characteristic.	May 2016 • Relevance and faithful representation are the two fundamental qualitative characteristics of useful financial information. • Reliability not reintroduced.
Completeness • Link discussion of completeness with ideas in the Disclosure Initiative.	• No change. Paragraph 2.14 is the same as paragraph 2.16 in the 2015 ED.
Primary users • NZASB said do not narrow the list of users (as suggested by some).	May 2016 • The IASB agreed and retained the existing description of the primary user group in Chapter 1 (paragraph 1.2).
Chapter 3—Financial statements and the reporting entity	
Q2(b) The boundary of a reporting entity • NZASB said the section needed more work. • Align discussion of reporting entity with concept of control and definition of an asset. Queried why the ED referred to 'direct' and 'indirect' control. • The Conceptual Framework should be clear about whether it has adopted the economic entity perspective or parent/proprietary perspective. • Be explicit about need for consolidation. • Don't include standards-level disclosure requirements about how to obtain consolidated statements.	September 2016 and June 2017 • The IASB decided to use the concepts underlying the notions of 'direct' and 'indirect' control, but not to use those terms. Paragraph 3.12 refers a reporting entity comprising two or more entities "that are not all linked by a parent-subsidiary relationship." • The IASB confirmed that financial statements are prepared from the perspective of the reporting entity as a whole (often referred to as the entity perspective) (paragraphs 3.8 and BC3.9). • Chapter 3 includes the statement that "when consolidated financial statements are required, unconsolidated financial statements cannot serve as a substitute for consolidated financial statements." (paragraphs 3.18 and BC3.22 to BC3.25) • The IASB did not include disclosure requirements about how to obtain consolidated statements.
Chapter 4—The elements of financial statements	
Q3(a) Definition of an asset and an economic resource • NZASB thought this section needed more work. Extensive discussion in comment letter. • Need to clarify what the idea of assets as bundles of rights means for unit of account, (de)recognition and measurement. • Commented on inconsistent derecognition requirements in existing standards.	July 2016 The 2018 *Conceptual Framework* continues to describe economic resources as a set of rights (paragraphs 4.6 to 4.13 and BC4.28 to BC4.31). The discussion of the forms that rights can take (see paragraph 4.6) has been rewritten but much of the remaining discussion remains unchanged. The IASB has clarified that "Although an economic resource derives its value from its present potential to produce future economic benefits, the economic resource is the present right that contains that potential, not the future economic benefits that the right may produce." (paragraph 4.17).
Q3(b) Definition of a liability • NZASB generally agreed, subject to comments on Q4.	November and December 2016 Necessary characteristics of a liability continue to include 'no practical ability to avoid' and 'as a result

NZASB's views (Nov 2015)[10]	IASB discussions and decisions[11]
	of past events' but the discussion has been refined (paragraph 4.26 onwards). The IASB reduced some discussion to avoid the risk of prejudging the outcome of the FICE project.
Q3(c) Definition of equity • NZASB was in general agreement	Define equity as 'the residual interest in the assets of the entity after deducting all its liabilities'
Q3(d)(e) Definitions of income and expense • NZASB was in general agreement	Definitions as per ED.
Q4 Present obligation Q5 Other guidance on the elements • NZASB had concerns about notion of economic compulsion. • Need to distinguish between present claims giving rise to future outflows and future obligations. • Better to focus on present claims. • Explain why a constructive obligation gives rise to a present claim. • Examples in comment letter used to highlight concerns. • Concerns that some guidance (paragraph 4.31(b)) was trying to deal with levies.	The IASB kept the criterion of 'no practical ability to avoid'. The IASB clarified what the phrase 'as a result of past events' means but did not address all of the NZASB's concerns (see paragraphs 4.43 onwards). The IASB did not include a description of a present obligation (because of the risk of prejudging the outcome of the FICE project).
Chapter 5—Recognition and derecognition	
Q6 Recognition criteria • NZASB was in broad agreement. • NZASB suggested stressing that all factors influencing must be considered *together*. • Concerns about wording of paragraph 5.9.	The discussion of factors influencing recognition has been revised in a way that acknowledges the NZASB's comment. Paragraph 5.13 now reads "The presence of one or both of the factors described in paragraph 5.12 does not lead automatically to a conclusion that the information provided by recognition lacks relevance…" The NZASB's concerns about paragraph 5.9 of the ED (now paragraph 5.7) were not addressed.
Q7 Derecognition • NZASB preferred 'control approach' in earlier DP. • Need to think more about links between the asset definition, the unit of account and derecognition.	No additional guidance on unit of account.
Chapter 6—Measurement	
Q8–Q10 Overall comments • NZASB thought this needed more work. • Develop measurement objective. • Consider how bases meet user needs and relate to qualitative characteristics. • Revise discussion of historical cost.	December 2016 The IASB did not develop a measurement objective but Chapter 6 does describe how measurement contributes to the objective of general purpose financial statements (see paragraph 6.45). The section on historic cost has been rewritten.
Measurement categories • NZASB disagreed with classification of bases. • NZASB disagreed with IASB's two categories and	The IASB did not change the categories. The BC explains why the IASB has categorised amortised cost as a form of historic cost (but the BC paragraphs on historic cost do not indicate how and why the IASB

NZASB's views (Nov 2015)[10]	IASB discussions and decisions[11]
suggested that the IASB consider the IPSASB's categorisation.	revised this section).
Information value of different measurement bases • NZASB said there was insufficient discussion and disagreed with some material.	The section on fair value is much shorter and some of the paragraphs the NZASB disagreed with have been deleted.
Q9 Factors to consider in selecting a measurement basis • NZASB said discussion too simplistic. • Place more emphasis on user needs, less on business model.	This section has been rewritten. It now acknowledges that both historic cost and current costs may provide relevant information when assets are used to produce cash flows indirectly. The Basis for Conclusions notes that the IASB did not intend to favour one measurement basis over another (paragraph BC6.17).
More than one relevant measurement basis • The NZASB was opposed to split measurement.	Chapter 6 still envisages the possibility of split measurement (see paragraphs 6.83 to 6.86). Chapter 7 refers to the possibility of taking changes in value to OCI *in exceptional circumstances* (see paragraph 7.17).
Chapter 7—Presentation and disclosure	
Q11-14 • NZASB said there was a lack of conceptual basis for OCI. IASB could say nothing about OCI or keep it high level. • Concerns that business model is being given too much emphasis. • Keep an open mind about where volatility should be reported. • Recycle all items reported in OCI.	Section rewritten. Rebuttable presumptions replaced by principles. Because the statement of profit or loss is the primary source of information about an entity's financial performance for the period, all income and expenses are, in principle, included in that statement. (paragraph 7.17) In principle income and expenses in OCI should be recycled: exceptions might be permitted in certain standards (paragraph 7.19).
Other questions for respondents	
Q16 Proposed approach to business activities • NZASB was generally supportive. • Don't place too much emphasis on business activities.	The IASB confirmed the approach in the ED. Business activities are discussed but are not introduced as an overarching concept.
IASB's conclusions on long-term investment • NZASB agreed that no need to refer specifically to long-term investment as a business activity. • NZASB disagreed with paragraph BCIN.36 which implied that historic cost is more suitable for long-term investments.	The 2018 *Conceptual Framework* does not refer explicitly to any particular business activity.
Chapter 8 Concepts of capital and capital maintenance • NZASB understood why the IASB did not want to rewrite the section on capital maintenance. • NZASB disagreed with paragraph BCIN.24 (inadequate and indicated a lack of understanding of the objective of capital maintenance concepts).	The IASB has carried forward the previous chapter, together with an explanatory comment noting that it has not been updated.
ED/2015/4 Updating references to the Conceptual Framework	

NZASB's views (Nov 2015)[10]	**IASB discussions and decisions**[11]
NZASB queried why the IASB was not also updating IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* paragraph 10 to refer to relevance and *faithful representation*.	The IASB has said (in the Basis for Conclusions on IAS 1) that, in order to avoid possible unintended consequences, it decided against replacing the term 'reliability' with the term 'faithful representation' in the Standards at this time.

Appendix 4 IASB and ASAF Meetings

This Appendix has been included to give the NZASB an overview of the IASB's redeliberations including the order in which it considered topics and the matters to which it devoted the most time. It lists the conceptual framework issues discussed at IASB and ASAF meetings in 2016 and 2017.

Meeting	Matters Considered
IASB 15 March 2016	Summary of the feedback received on the Conceptual Framework Exposure Draft. **Agenda Paper 10: Conceptual Framework: Feedback summary—Overview** 10A: Chapter 1—The objective of general purpose financial reporting[12] 10B: Chapter 2—Qualitative characteristics of useful financial information 10C: Chapter 3—Financial statements and the reporting entity 10D: Elements of financial statements—Assets 10E: Elements of financial statements—Liabilities and equity 10F: Elements of financial statements—Income, expenses and undefined elements 10G: Recognition 10H: Derecognition 10I: Measurement and Capital Maintenance 10J: Presentation and disclosure 10K: Information about financial performance 10L: Business activities and long-term investment 10M: User outreach 10N: Effects and Updating References ED 10O: Key messages
ASAF 7–8 April 2016	IASB staff sought ASAF members' advice on its strategy for developing the Conceptual Framework. Feedback was sought on the following questions. (a) Which of the Exposure Draft proposals should the Board focus on during redeliberations? (b) What strategy should the Board adopt in the following areas: (i) measurement; and (ii) reporting financial performance (profit or loss and OCI)? (c) What are your views on the timetable for the project? Should the Board: (i) continue with its plan to finalise the Conceptual Framework on a timely basis; (ii) delay finalising the Conceptual Framework to further develop some areas; or (iii) finalise some sections of the Conceptual Framework and undertake further work on other sections? (d) Respondents to the Exposure Draft were generally supportive of the Board's decision to explore the problems associated with the distinction between liabilities and equity as part of a separate research project rather than as part of the Conceptual Framework. Do you support this decision? (e) Do you think that the Board should treat the Conceptual Framework as a 'living document'? That is, should the Conceptual Framework be updated if research on other projects highlights the need to do so? ASAF members were also asked to provide feedback on a proposal by the European Financial Reporting Advisory Group (EFRAG) to expand Chapter 6 *Measurement*.
IASB	The IASB discussed strategy for finalising the Conceptual Framework. The IASB received

[12] The title of each IASB agenda paper referred to in this table referred to the Conceptual Framework. We used shorter titles as the topic is clear from the context.

Meeting	Matters Considered
20 April 2016	a verbal summary of ASAF's advice (from the April ASAF meeting). **Agenda Paper 10: Conceptual Framework** Cover note 10A: Purpose and status of the Conceptual Framework 10B: Approach to redeliberations 10C: Approach to redeliberations—Measurement 10D: Approach to redeliberations—Reporting financial performance 10E: Approach to redeliberations—Concepts for liabilities and equity
IASB 18 May 2016	**Agenda Paper 10: Conceptual Framework** Cover note 10A: Summary of tentative decisions 10B: Chapters 1 and 2—Introduction 10C: Stewardship 10D: Prudence 10E: Measurement uncertainty
IASB 22 June 2016	**Agenda Paper 10: Conceptual Framework** Cover paper 10A: Summary of tentative decisions 10B: Definitions of income and expenses 10C: Information about financial performance
ASAF 7–8 July 2016	ASAF members' advice was sought on: (a) proposals to refine the proposed concepts supporting the liability definition. One proposal was to add a requirement for a 'present claim against the entity'. Refinements were proposed to reduce the risk of adding concepts that might have to be withdrawn as a result of the research project on Financial Instruments with Characteristics of Equity (FICE); (b) the circumstances in which economic compulsion should be considered when classifying claims as liabilities or equity; and (c) suggestions for improving the concepts relating to the recognition of assets and liabilities with a low probability of inflows or outflows of economic benefits.
IASB 18 July 2016	**Agenda Paper 10: Conceptual Framework** Cover paper 10A: Summary of tentative decisions 10B: Asset definition and supporting concepts 10C: Recognition 10D: Measurement: Factors to consider when selecting a measurement basis
IASB 22 Sept 2016	**Agenda Paper 10: Conceptual Framework** Cover paper 10A: Summary of tentative decisions 10B: The reporting entity 10C: Presentation and disclosure 10D: Asymmetry in treating gains and losses 10E: Definition of equity and supporting discussion 10F: Materiality 10G: Measurement—redrafting factors to consider in selecting a measurement basis 10H: Measurement: suggested redraft of parts of Chapter 6 10I: Measurement
ASAF 29 Sept 2016	ASAF members considered: (a) a paper on measurement prepared and presented by EFRAG; (b) an IASB staff draft of proposed revisions to the discussion of factors to be

Meeting	**Matters Considered**
	considered in selecting a measurement basis; (c) an update on the Board's tentative decisions on presenting information about financial performance; and (d) a paper on financial performance and measurement prepared by the Accounting Standards Board of Japan (ASBJ).
IASB 18 Oct 2016	**Agenda Paper 10: Conceptual Framework** Cover paper 10A: Summary of tentative decisions 10B: Testing the proposed asset and liability definitions—matters arising 10C: Testing the proposed asset and liability definitions—illustrative examples 10D: Executory contracts 10E: Unit of account 10F: Agenda reference not used 10G: Asymmetry 10H: Materiality
IASB 15 Nov 2016	**Agenda Paper 10: Conceptual Framework** Cover paper 10A: Summary of tentative decisions 10B: Liability definition and supporting concepts—background information 10C: Liability definition and supporting concepts—the 'no practical ability to avoid' criterion 10D: Liability definition and supporting concepts—reducing the risk of further changes 10E: Liability definition and supporting concepts—other topics 10F: Testing the proposed asset and liability definitions—illustrative examples 10G: Effects of the proposed changes to the Conceptual Framework on preparers
ASAF 8–9 Dec 2016	At this meeting, ASAF members were asked for their views about: (a) the Board's tentative decisions at its November 2016 meeting on the liability definition and supporting concepts in the exposure draft, in particular, on the criteria of 'no practical ability to avoid' and 'as a result of past events'; and (b) staff recommendations for the approach to capital maintenance (that is, to keep the old text and note that it has not been reconsidered).
IASB 14 Dec 2016	**Agenda Paper 10: Conceptual Framework** Cover paper 10A: Summary of tentative decisions 10B: Measurement—redrafting factors to consider in selecting a measurement basis 10C: Measurement: suggested redraft of parts of Chapter 6 10D: Measurement: comparison of suggested redraft of parts of Chapter 6 with the Exposure Draft 10E: Business activities and long-term investment 10F: Concepts of capital and capital maintenance 10G: Derecognition
IASB 18 Jan 2017	**Agenda Paper 10: Conceptual Framework** Cover paper 10A: Summary of tentative decisions 10B: Factors specific to initial measurement 10C: Factors specific to initial measurement—illustrative drafting 10D: More than one relevant measurement basis 10E: Updating References Exposure Draft—proposed amendments 10F: Updating References Exposure Draft—transition and effective date
IASB 23 Feb 2017	**Agenda Paper 10: Conceptual Framework** Cover paper

Meeting	Matters Considered
	10A: Summary of tentative decisions 10B: Measurement Appendix A: Cash-flow-based measurement techniques 10C: Review of existing Standards for potential inconsistencies with the revised Conceptual Framework 10D: Effects of the revised Conceptual Framework 10E: Minor comments on concepts supporting asset and liability definitions 10F: Due process summary for the Conceptual Framework for Financial Reporting
ASAF 6–7 Mar 2017	ASAF members received a summary of the tentative decisions made in the course of the IASB's redeliberations. No feedback was sought.
IASB 21 Mar 2017	**Agenda Paper 10: Conceptual Framework** Cover paper 10A: Summary of tentative decisions 10B: Applying the amendment to paragraph 11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to rate-regulated activities 10C: Due process summary for References to the Conceptual Framework
IASB 21–22 June 2017	**Agenda Paper 10: Conceptual Framework** Sweep issue: Boundary of a reporting entity
IASB 20–21 Sept 2017	**Agenda Paper 10: Conceptual Framework** The IASB discussed sweep issues arising from the review of the pre-ballot draft of the Conceptual Framework. 10A: Sweep issue: Measurement uncertainty The IASB discussed comments received on measurement uncertainty and related comments on the fundamental qualitative characteristics of useful financial information and tentatively decided to make clarifications to that discussion.
World standard setters 25 Sept 2017	Delegates discussed the main concepts that will be included in the revised Conceptual Framework for Financial Reporting and applied them to illustrative examples. They also received an update on the status and the timeline of the project.
IASB 24–5 Oct 2017	**Agenda Paper 10: Conceptual Framework** The IASB discussed sweep issues arising from the review of the pre-ballot draft of the Conceptual Framework. 10A: Sweep issue—concepts supporting the liability definition 10B: Sweep issue: a flowchart for Chapter 1
AOSSG[13] 29–30 Nov 2017	IASB representatives presented on the revised Conceptual Framework, focusing on the recognition criteria for assets and liabilities, the selection of a measurement basis, the principle of classification into profit or loss and other comprehensive income. AOSSG members generally supported the forthcoming Conceptual Framework. Some expressed concerns about the definition of liabilities and related guidance (specifically the inclusion of 'no practical ability to avoid') and the principle of classification into profit or loss and other comprehensive income. The IASB Chair acknowledged the concerns raised and indicated that the IASB may consider further clarifications that the new definition of a liability should not be used when interpreting existing IFRS Standards, such as IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.
IASB 24–25 Jan 2018	**Agenda Paper 10: Conceptual Framework** The IASB received an update on the project and expected publication date.

[13] Asian-Oceanian Standard-setters Group

Appendix 5 IASB and IPSASB frameworks

IASB Conceptual Framework	IPSASB/PBE Conceptual Framework
Preface	
The IASB framework does not have a Preface. The IFRS Foundation focuses on developing standards that provide high quality information for capital markets.	The Preface highlights characteristics of public sector entities that influenced the development of the IPSASB's Conceptual Framework. The PBE Conceptual Framework has a preface that includes characteristics of both public sector and NFP PBEs.
Objectives	
The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about relating to providing resources to the entity. It refers to assessments of stewardship as a factor that influences users' expectations about returns.	The IPSASB framework focuses on decision making and accountability. The key users referred to are resource providers and service recipients.
Qualitative characteristics	
Fundamental QCs • Relevance • Reliability Enhancing QCs • Comparability • Verifiability • Timeliness • Understandability	The qualitative characteristics are the same but the IPSASB has not differentiated between fundamental and enhancing characteristics.
Elements	
Asset: A present economic resource controlled by the entity as a result of past events. [An economic resource is a right that has the potential to produce economic benefits.] Liability: A present obligation of the entity to transfer an economic resource as a result of past events. Income: Increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims. Expenses: Decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims. Equity: The residual interest in the assets of the entity after deducting all its liabilities. Equity claim: A claim on the residual interest in the assets of the entity after deducting all its liabilities.	Asset: A resource presently controlled by the entity as a result of a past event. [A resource is an item with service potential or the ability to generate economic benefits]. Liability: A present obligation of the entity for an outflow of resources that results from a past event. [Includes discussion of legal obligations and non-legally binding obligations. The IPSASB has left open the possibility of recognising items that do not meet the definition of a liability.] Revenue: Increases in the net financial position of the entity, other than increases arising from ownership contributions. Expense: Decreases in the net financial position of the entity, other than decreases arising from ownership distributions. Ownership contribution: Inflows of resources to an entity, contributed by external parties in their capacity as owners, which establish or increase an interest in the net financial position of the entity. Ownership distribution: Outflows of resources

IASB Conceptual Framework	**IPSASB/PBE Conceptual Framework**
Other changes in economic resources and in claims (not defined terms) • Contributions from holders of equity claims, and distributions to them. • Exchanges that do not result in increases or decreases in equity (for example, acquiring an asset for cash).	from the entity, distributed to external parties in their capacity as owners, which return or reduce an interest in the net financial position of the entity. **PBE Conceptual Framework** Equity: The residual interest in the assets of the entity after deducting all its liabilities. Includes elements of Service Performance Reporting.
Recognition	
Discusses the need for items to meet the definition of an element and for recognition to be 'useful' to users. The section on recognition criteria draws heavily on the two fundamental qualitative characteristics.	The recognition criteria are that an item: • satisfies the definition of an element; and • can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in GPFRs.
Measurement	
No measurement objective. Use QCs to guide selection of bases. Could have more than one measurement basis for an item. <u>Bases</u> Historical cost Current Value • *Fair value* • Value in use and fulfilment value • Current cost	The objective of measurement is: To select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes. <u>Bases</u> Classifies measurement bases as: • entry or exit values • observable or unobservable measures • entity-specific and non-entity specific measures <u>Bases for Assets</u>: Historical Cost; Current Value Measurements; *Market Value*; Replacement Cost; Net Selling Price; Value in Use <u>Bases for Liabilities</u>: Historical Cost; Cost of Fulfilment; *Market Value*; Cost of Release; Assumption Price
Presentation	
Refers to presentation and disclosure. Contains: • concepts that describe how information should be presented and disclosed in financial statements; • guidance on classifying income and expenses (in profit or loss or OCI); and • guidance on reclassifying items in OCI.	Presentation: the selection, location and organisation of information reported in GPFRs. Information might be selected for: • display (on the face); or • disclosure (in the notes). Discusses principles for: • information selection; • information location; and • information organisation. No reference to OCI.

IASB Conceptual Framework	**IPSASB/PBE Conceptual Framework**
Other comments	
The chapters on the objective of GPFR (Chapter 1) and the QCs (Chapter 2) apply to both GPFR and financial statements. All the other chapters (Chapters 3–8) focus on information provided in the financial statements. They do not address other forms of financial reporting.	The chapter on Presentation also applies to both GPFR and financial statements. **PBE Conceptual Framework** As per the IPSASB Conceptual Framework. In addition, the chapter on elements applies to both GPFR and financial statements.

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	20 April 2018
To:	NZASB Members
From:	Joanne Scott
Subject:	**New Zealand-specific amendments**

Introduction

1. This memo explains (i) the IASB's approach to identifying amendments to standards as a result of the 2018 *Conceptual Framework* and (ii) the process we used to identify New Zealand-specific amendments as a result of the revised conceptual framework.

Recommendations[1]

2. We recommend that the Board AGREES to:

   (a) AMEND NZ IAS 1 *Presentation of Financial Statements* (paragraph RDR 15.1);

   (b) AMEND NZ IFRS 4 *Insurance Contracts* (Appendix C paragraph 14.1.7 and Appendix D paragraph 17.6.4); and

   (c) ADVISE the XRB Board to amend XRB A1 *Application of the Accounting Standards Framework* (Appendix B), EG A1 *Guide to Application of the Accounting Standards Framework* and EG A2 *Overview of the Accounting Standard Setting Process*.

3. We also recommend that the Board AGREES to PROPOSE amendments to FRS-42 *Prospective Financial Statements* in a future omnibus ED.

IASB's approach to amendments

4. The IASB's amendments are based on proposals from ED/2015/4 *Updating References to the Conceptual Framework*, published in May 2015. The IASB is amending as little as possible. Most of the IASB's amendments are to add references to the 2018 *Conceptual Framework* and to update or delete footnotes that referred to previous frameworks.

5. Although the IASB issued a new framework chapter on qualitative characteristics in 2010, a number of standards[2] still refer to the pre-2010 qualitative characteristics, especially relevance and reliability. Unlike the IPSASB, the IASB is not updating most of these references. Despite acknowledging the IASB's approach and wanting to maintain consistency with the

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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).

2 For example, IAS 1 (a number of instances), IAS 8 (paragraphs 1 and 10), IFRS 7 (paragraph B7) and IFRS 16 (paragraph 31).

IASB's approach, we think that a few references to qualitative characteristics in NZ IFRS 4 and FRS-42 should be updated, now or in the near future.

6. The changes in the qualitative characteristics between 1989 and 2018 are shown below.

Qualitative characteristics (1989)	**Qualitative characteristics (2010 and 2018)**

Four principal qualitative characteristics
• Understandability
• Relevance
  o Materiality
• Reliability
  o Faithful representation
  o Substance over form
  o Neutrality
  o Prudence
  o Completeness
• Comparability
Constraints on relevant and reliable information
• Timeliness
• Balance between benefit and cost
• Balance between qualitative characteristics
	Fundamental qualitative characteristics
	• Relevance
	  o Materiality
	• Faithful representation (complete, neutral* and free from error)
	Enhancing qualitative characteristics
	• Comparability
	• Verifiability
	• Timeliness
	• Understandability
	The cost constraint on useful financial reporting
	
	* The 2018 version states that neutrality is supported by the exercise of prudence.

Process for identifying New Zealand-specific amendments

7. We searched each NZ IFRS for terms such as framework, concept, relevant/relevance and reliable/reliability. We also looked at the New Zealand-specific paragraphs in each NZ IFRS based on an IFRS Standard. We identified three standards where we think the qualitative characteristics should be updated. In the case of NZ IAS 1 and NZ IFRS 4 we think the amendments are minor and should be made now. In the case of FRS-42 we think that the amendments are not urgent and should be exposed for comment.

NZ IAS 1 *Presentation of Financial Statements*

8. NZ IAS 1 paragraph RDR 15.1 refers to the definitions and recognition criteria in the NZ *Framework*. We propose to amend paragraph RDR 15.1 so that it is consistent with the IASB's amendments to paragraph 15 (see below). This amendment is included in the draft amending standard at agenda item 8.4.

***15 Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the ~~NZ *Framework*~~ New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* (2018 *NZ Conceptual Framework*).[3] The application of NZ IFRS, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation.**

RDR 15.1 Financial statements shall present fairly the financial position, financial performance and cash flows of a Tier 2 entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the 2018 *NZ Conceptual Framework*. The application of the New Zealand equivalents to International Financial Reporting Standards

Reduced Disclosure Regime (NZ IFRS RDR), with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation.

~~3 Paragraphs 15–24 contain references to the objective of financial statements set out in the *Framework [for the Preparation and Presentation of Financial Statements]*. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*, which replaced the objective of financial statements with the objective of general purpose financial reporting: see Chapter 1 of the NZ *Framework*.~~

Question 1
Does the Board agree to amend NZ IAS 1 paragraph RDR 15.1 as shown above?

<u>NZ IFRS 4 *Insurance Contracts*</u>

9. IFRS 4 *Insurance Contracts* (paragraphs 22, 27 and 28) refer to relevance and reliability. The IASB is not amending these paragraphs and we propose no changes to those paragraphs. Appendices C and D of NZ IFRS 4 also refer to the qualitative characteristics of financial statements. We could easily update those paragraphs and avoid confusion by deleting a few words. Our proposed amendments are shown below. These amendments, including a new effective date paragraph, are included in the draft amending standard at agenda item 8.4.

NZ IFRS 4 Appendix C

14.1.7 When a life insurer is presenting the disclosures required by paragraphs 14.1.1(c) and 14.1.1(d) the insurer determines the level and extent of disclosure that is appropriate having regard to its circumstances and the qualitative characteristics of financial statements under the ~~New Zealand~~ <u>2018 *NZ Conceptual*</u> *Framework* ~~of understandability, relevance, reliability and comparability~~.

…

NZ IFRS 4 Appendix D

17.6.4 When an insurer is presenting the disclosures required by paragraphs 17.6.1(c) and 17.6.1(d) the insurer determines the level and extent of disclosure that is appropriate having regard to its circumstances and the qualitative characteristics of financial statements under the ~~New Zealand~~ <u>2018 *NZ Conceptual*</u> *Framework*~~, of understandability, relevance, reliability and comparability~~.

10. We acknowledge that NZ IFRS4 will be superseded by NZ IFRS 17 *Insurance Contracts* but NZ IFRS 17 is not effective until 1 January 2021. The amendments arising from the 2018 *NZ Conceptual Framework* would be effective from 1 January 2020.

Question 2
Does the Board agree to amend NZ IFRS 4 (Appendix C paragraph 14.1.7 and Appendix D paragraph 17.6.4) as shown above?

<u>XRB A1 *Application of the Accounting Standards Framework*</u>

11. As is usual with a new pronouncement, the amending standard also updates Appendix B of XRB A1.

<u>Explanatory Guides</u>

12. EG A1 and EG A2 include references to the NZ *Conceptual Framework* issued in 2011 that need to be updated. The guides are not authoritative and changes to them do not have to be exposed for comment in the same way as standards. Because these guides are issued by the XRB Board, the NZASB advises the XRB Board of any proposed changes.

13. The proposed amendments to EG A1 and EG A2 are set out in Appendix 1 to this memo.

> **Question 4**
>
> Does the Board agree to advise the XRB Board to amend EG A1 and EG A2 (as shown in Appendix 1 to this memo?)

FRS-42 *Prospective Financial Statements*

14. Paragraph 16 of FRS-42 refers to the qualitative characteristics in the 2010 NZ *Framework* and paragraph 17 explains what each of the characteristics means in the context of prospective financial statements. The Introduction and paragraphs 30 and 32 also refer to the qualitative characteristics.

15. We think that the discussion of, and references to, the qualitative characteristics in FRS-42 should be updated and aligned with the qualitative characteristics in the 2018 *NZ Conceptual Framework* in the near future. Our reasons are as follows.

    (a) FRS-42 is a domestic standard. It is up to us when we update it and we think that it would be best to do this fairly soon.

    (b) We have already updated the equivalent discussion of the qualitative characteristics in PBE FRS 42 *Prospective Financial Statements* to align with the qualitative characteristics in the PBE Conceptual Framework.

16. For your information, the future amendments that we think would be necessary are shown below. The draft amendments are equivalent to those made to PBE FRS 42 *Prospective Financial Statements* in the *2016 Omnibus Amendments to PBE Standards*.

Main features of the Standard

...

The Standard requires that an entity use the best information that could reasonably be expected to be available in determining the assumptions and other information used in the preparation of general purpose prospective financial statements. It also requires that the prospective financial statements be understandable, relevant, faithfully representative ~~reliable~~ and comparable and that the information in the prospective financial statements be reasonable and supportable.

…

16 In order to meet the needs of users, prospective financial statements shall meet the qualitative characteristics outlined in the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* (2018 *NZ Conceptual Framework*) ~~*the Preparation and Presentation of Financial Statements*~~[3] ~~(NZ *Framework*)~~. Accordingly, the statements shall be relevant, faithfully representative, understandable, timely, comparable and verifiable ~~understandable, relevant, reliable and comparable~~.

17 In giving effect to the principle in paragraph 16, for prospective financial statements to be:

~~(a)~~ ~~**understandable**—the information in the statements should be described, aggregated, classified and presented in a format and style that is able to be clearly understood by users. For prospective financial statements to be understandable, users will need sufficient information to be able to make judgements about the assumptions employed and the risks associated with those assumptions.~~

(~~b~~a) **relevant**—the information in the statements should be capable of assisting users to make economic or other decisions by helping them evaluate present or future events or correct their past evaluations. For prospective financial statements to be relevant they must have predictive value and be able to be confirmed, or otherwise, in future periods.

(~~c~~b) **faithfully representative~~reliable~~**~~—~~the information in the statements should be complete, neutral and free from material ~~calculation~~ error~~, and unbiased~~. The extent to which prospective fianncial statements can be described as faithfully representative ~~reliability of prospective financial statements~~ is affected by the appropriateness of the assumptions and the sources of uncertainty. Users should be able to assess the extent to which ~~reliability of~~ prospective financial statements are faithfully representative and identify the factors that make the statements more or less faithfully representative ~~reliable~~.

(c) **understandable**—the information in the statements should be described, aggregated, classified and presented in a format and style that is able to be clearly understood by users. For prospective financial statements to be understandable, users will need sufficient information to be able to make judgements about the assumptions employed and the risks associated with those assumptions.

(d) **timely**—the information should be reported to users before it loses its capacity to be useful for accountability and decision-making purposes.

(~~d~~e) **comparable**—the statements should measure and display like items, transactions and events in a consistent manner. Prospective financial statements should be capable of comparison with current and subsequent information about the actual financial performance of an entity based on consistent application of accounting policies, reporting periods and presentation.

(f) **verifiable—**the statements should be transparent about the assumptions that underlie the information disclosed, the methodologies adopted in compiling that information, and the factors and circumstances that support any opinions expressed or disclosures made.

~~3 In February 2011 the NZ *Framework for the Preparation and Presentation of Financial Statements* was replaced with the equivalent to the IASB *Conceptual Framework for Financial Reporting*. The qualitative characteristic of reliability in the old *Framework* is the same as the qualitative characteristic of faithful representation in the *Conceptual Framework*.~~

…

30 All assets and liabilities shall be presented broadly in order of liquidity when a presentation based on liquidity provides information that is faithfully representative ~~reliable~~ and is more relevant and when the entity intends to present its assets and liabilities in order of liquidity in its historical financial statements.

32 In addition to the information required by paragraph 31, an entity shall present, either on the face of the statement of profit or loss and other comprehensive income or in the notes, an analysis of expenses using a classification based on either the nature of expenses or their function within the entity, whichever provides information that is faithfully representative ~~reliable~~ and more relevant.

Possible BC paragraph for FRS-42

BCx. Following the issue of the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* in May 2018 the NZASB aligned the discussion of the qualitative characteristics in FRS-42 with the qualitative characteristics in that framework. The Board sought feedback on these amendments from constituents in [ED 2018-X *Title*].

17. We recommend that any amendments to FRS-42 be exposed for comment in a future omnibus ED (Option A).

18. An alternative (Option B) would be to issue the amendments to FRS-42 as part of *Amendments to References to the Conceptual Framework in NZ IFRS*. The pros and cons of the two options are set out below. Both options would result in FRS-42 being amended twice in a short time.[3]

[3] Amendments to the scope of FRS-42 are also being considered at this meeting (see agenda item 9).

When to amend FRS-42	**Pros**	**Cons**
Option A (recommended) Propose amendments to FRS-42 in an Omnibus ED	Consistent with usual due process.[4]	Need to wait for next Omnibus ED.
Option B (alternative) Include amendments in *Amendments to References to the Conceptual Framework in NZ IFRS*	All amendments to NZ IFRS arising from the revised conceptual framework would be set out in one document.	Not consistent with usual due process.

Question 3

Does the Board agree to propose amendments to FRS-42 (as shown above) in a future omnibus ED (Option A)?

[4] The Financial Reporting Act, section 22, states that the Board "must not issue a standard, an authoritative notice, an amendment, or a revocation unless the Board has taken reasonable steps to consult the persons or representatives of persons who, in the opinion of the Board, would be substantially affected by the issue of the standard, notice, amendment, or revocation."

Appendix 1 Amendments to Explanatory Guides

This Appendix identifies amendments to the XRB's Explanatory Guides following the issue of the 2018 *NZ Conceptual Framework*. The two Explanatory Guides affected are:

- EG A1 *Guide to Application of the Accounting Standards Framework*; and
- EG A2 *Overview of the Accounting Standard Setting Process.*

EG A1 *Guide to Application of the Accounting Standards Framework*

The footnote to paragraph 24 is amended. Paragraphs 43 (and accompanying footnote), 46 and 47 are amended. New text is underlined and deleted text is struck through.

…

General Purpose Financial Reports

24 The objective of GPFR is to provide information to users for decision-making or accountability purposes where those users are generally unable to obtain the information they require. By definition therefore GPFR seeks to provide information to a range of general purpose users with different interests in that information. GAAP and "non-GAAP standards" issued by the XRB reflect this.[12]

[12] The objective of GPFR, the users of GPFR and the information needs of such users are discussed in detail in the New Zealand <u>E</u>~~e~~quivalent to the IASB *Conceptual Framework for Financial Reporting* ~~*2010*~~ <u>issued in 2018 (2018 *NZ Conceptual Framework*)</u> ~~(NZ *Framework*~~ and the *Public Benefit Entities' Conceptual Framework* (PBE Conceptual Framework).

…

For-Profit Requirements

43 The requirements to be applied by for-profit entities are the New Zealand equivalents to International Financial Reporting Standards (NZ IFRS). NZ IFRS is the set of standards and interpretations issued by the NZASB (or approved by the XRB's predecessor body, the ASRB). It comprises New Zealand equivalents to:

- International Financial Reporting Standards;
- International Accounting Standards;
- IFRIC Interpretations; and
- SIC Interpretations.

The NZ IFRS set of standards also includes a small number of (domestic) New Zealand Financial Reporting Standards (FRSs) and the ~~New Zealand equivalent to the IASB *Conceptual Framework for Financial Reporting* (2010) (NZ *Framework*)~~ <u>2018 *NZ Conceptual Framework*</u>.[15]

[15] ~~The IASB is in the process of developing a new conceptual framework~~. <u>The 2018 *NZ Conceptual Framework* (issued May 2018) is effective for annual periods beginning on or after 1 January 2020. From the point at which the 2018 *NZ Conceptual Framework* becomes effective, entities will refer to the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* (2010) (NZ *Framework*) in the limited circumstances that they are required to do so by the relevant NZ IFRS.</u>

…

46 The <u>topics addressed in the 2018 *NZ Conceptual Framework* are</u>~~NZ *Framework* addresses~~:

- <u>Status and purpose of the 2018 *NZ Conceptual Framework*;</u>
- <u>Chapter 1—The Objective of General Purpose Financial Reporting;</u>
- <u>Chapter 2—Qualitative Characteristics of Useful Financial Information;</u>

- Chapter 3—Financial Statements and the Reporting Entity;
- Chapter 4—The Elements of Financial Statements;
- Chapter 5—Recognition and Derecognition;
- Chapter 6—Measurement;
- Chapter 7—Presentation and Disclosure; and
- Chapter 8—Concepts of Capital and Capital Maintenance.
- ~~The objectives and users of GPFR;~~
- ~~The qualitative characteristics of useful information;~~
- ~~The underlying assumptions on which the financial statements are normally prepared;~~
- ~~The elements of financial statements and their recognition and measurement; and~~
- ~~The concepts of capital and capital maintenance.~~

47 In the absence of an accounting standard, the 2018 *NZ Conceptual Framework* ~~NZ *Framework*~~ assists the NZASB in developing a New Zealand FRS or in ~~working with the IASB to develop an IFRS~~ its role in commenting on the development of an IFRS by the IASB. The ~~NZ *Framework*~~ 2018 *NZ Conceptual Framework* also ~~provides a basis for the use of judgement by preparers in resolving accounting issues~~ assists preparers of GPFR. For example, it may assist preparers in developing consistent accounting policies when dealing with topics that have yet to form the subject of a NZ IFRS or when a Standard allows a choice of accounting policy.

EG A2 *Overview of the Accounting Standard Setting Process*

Paragraph 10 is amended. New text is underlined and deleted text is struck through.

…

THE NZASB'S STANDARD SETTING PROCESS

The standard setting environment

…

10 In the for-profit sector, the NZASB issues ~~the~~ New Zealand e~~E~~quivalents to the IASB's Conceptual Frameworks ~~*for Financial Reporting 2010* (NZ *Framework*)~~ as ~~an~~ Authoritative Notices.

New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* (2018 *NZ Conceptual Framework*)

Issued May 2018

Issued by the New Zealand Accounting Standards Board of the External Reporting Board

This Authoritative Notice, the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* (2018 *NZ Conceptual Framework*), was issued by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(c) of the Financial Reporting Act 2013.

This Authoritative Notice is a disallowable instrument for the purposes of the Legislation Act 2012.

This Authoritative Notice is effective for annual periods beginning on or after 1 January 2020. Earlier application is permitted.

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IFRS Foundation Publications Department
30 Cannon Street, London, EC4M 6XH, United Kingdom.
Tel: +44 (0)20 7332 2730 Fax: +44 (0)20 7332 2749
Email: publications@ifrs.org Web: www.ifrs.org

CONTENTS

APPENDIX—DEFINED TERMS

The following is available within New Zealand on the XRB website as additional material

Approval by the IASB of the *Conceptual Framework for Financial Reporting* issued in March 2018

STATUS AND PURPOSE OF THE *CONCEPTUAL FRAMEWORK*

SP1.1 The IASB's *Conceptual Framework for Financial Reporting* issued in 2018 (IASB's *Conceptual Framework*) describes the objective of, and the concepts for, general purpose financial reporting. The purpose of the IASB's *Conceptual Framework* is to:

(a) assist the International Accounting Standards Board (IASB) to develop IFRS Standards (Standards) that are based on consistent concepts;

(b) assist preparers to develop consistent accounting policies when no Standard applies to a particular transaction or other event, or when a Standard allows a choice of accounting policy; and

(c) assist all parties to understand and interpret the Standards.

SP1.2 The IASB's *Conceptual Framework* is not a Standard. Nothing in the IASB's *Conceptual Framework* overrides any Standard or any requirement in a Standard.

SP1.3 To meet the objective of general purpose financial reporting, the IASB may sometimes specify requirements that depart from aspects of the IASB's *Conceptual Framework*. If the IASB does so, it will explain the departure in the Basis for Conclusions on that Standard.

SP1.4 The IASB's *Conceptual Framework* may be revised from time to time on the basis of the IASB's experience of working with it. Revisions of the IASB's *Conceptual Framework* will not automatically lead to changes to the Standards. Any decision to amend a Standard would require the IASB to go through its due process for adding a project to its agenda and developing an amendment to that Standard.

SP1.5 The IASB's *Conceptual Framework* contributes to the stated mission of the IFRS Foundation and of the IASB, which is part of the IFRS Foundation. That mission is to develop Standards that bring transparency, accountability and efficiency to financial markets around the world. The IASB's work serves the public interest by fostering trust, growth and long-term financial stability in the global economy. The IASB's *Conceptual Framework* provides the foundation for Standards that:

(a) contribute to transparency by enhancing the international comparability and quality of financial information, enabling investors and other market participants to make informed economic decisions.

(b) strengthen accountability by reducing the information gap between the providers of capital and the people to whom they have entrusted their money. Standards based on the IASB's *Conceptual Framework* provide information needed to hold management to account. As a source of globally comparable information, those Standards are also of vital importance to regulators around the world.

(c) contribute to economic efficiency by helping investors to identify opportunities and risks across the world, thus improving capital allocation. For businesses, the use of a single, trusted accounting language derived from Standards based on the IASB's *Conceptual Framework* lowers the cost of capital and reduces international reporting costs.

NZ SP1.5.1 In accordance with the Accounting Standards Framework in New Zealand the External Reporting Board issued the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* (2018 *NZ Conceptual Framework*).

EFFECTIVE DATE

NZ SP1.5.2 This Authoritative Notice is effective for annual periods beginning on or after 1 January 2020. Earlier application is permitted.

from paragraph

CHAPTER 1—THE OBJECTIVE OF GENERAL PURPOSE FINANCIAL REPORTING

Introduction

1.1 The objective of general purpose financial reporting forms the foundation of the 2018 *NZ Conceptual Framework*. Other aspects of the 2018 *NZ Conceptual Framework*—the qualitative characteristics of, and the cost constraint on, useful financial information, a reporting entity concept, elements of financial statements, recognition and derecognition, measurement, presentation and disclosure—flow logically from the objective.

Objective, usefulness and limitations of general purpose financial reporting

1.2 The objective of general purpose financial reporting[1] is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity.[2] Those decisions involve decisions about:

(a) buying, selling or holding equity and debt instruments;

(b) providing or settling loans and other forms of credit; or

(c) exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.

1.3 The decisions described in paragraph 1.2 depend on the returns that existing and potential investors, lenders and other creditors expect, for example, dividends, principal and interest payments or market price increases. Investors', lenders' and other creditors' expectations about returns depend on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity and on their assessment of management's stewardship of the entity's economic resources. Existing and potential investors, lenders and other creditors need information to help them make those assessments.

1.4 To make the assessments described in paragraph 1.3, existing and potential investors, lenders and other creditors need information about:

(a) the economic resources of the entity, claims against the entity and changes in those resources and claims (see paragraphs 1.12–1.21); and

(b) how efficiently and effectively the entity's management and governing board[3] have discharged their responsibilities to use the entity's economic resources (see paragraphs 1.22–1.23).

1.5 Many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial reports are directed.[4]

1.6 However, general purpose financial reports do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need. Those users need to consider pertinent information from other sources, for example, general economic conditions and expectations, political events and political climate, and industry and company outlooks.

1.7 General purpose financial reports are not designed to show the value of a reporting entity; but they provide information to help existing and potential investors, lenders and other creditors to estimate the value of the reporting entity.

1.8 Individual primary users have different, and possibly conflicting, information needs and desires. The Board, in developing Standards, will seek to provide the information set that will meet the needs of the maximum number of primary users. However, focusing on common information needs does not prevent the reporting entity from including additional information that is most useful to a particular subset of primary users.

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1 Throughout the 2018 *NZ Conceptual Framework*, the terms 'financial reports' and 'financial reporting' refer to general purpose financial reports and general purpose financial reporting unless specifically indicated otherwise.

2 Throughout the 2018 *NZ Conceptual Framework*, the term 'entity' refers to the reporting entity unless specifically indicated otherwise.

3 Throughout the 2018 *NZ Conceptual Framework*, the term 'management' refers to management and the governing board of an entity unless specifically indicated otherwise.

4 Throughout the 2018 *NZ Conceptual Framework*, the terms 'primary users' and 'users' refer to those existing and potential investors, lenders and other creditors who must rely on general purpose financial reports for much of the financial information they need.

1.9 The management of a reporting entity is also interested in financial information about the entity. However, management need not rely on general purpose financial reports because it is able to obtain the financial information it needs internally.

1.10 Other parties, such as regulators and members of the public other than investors, lenders and other creditors, may also find general purpose financial reports useful. However, those reports are not primarily directed to these other groups.

1.11 To a large extent, financial reports are based on estimates, judgements and models rather than exact depictions. The 2018 *NZ Conceptual Framework* establishes the concepts that underlie those estimates, judgements and models. The concepts are the goal towards which the Board and preparers of financial reports strive. As with most goals, the 2018 *NZ Conceptual Framework*'s vision of ideal financial reporting is unlikely to be achieved in full, at least not in the short term, because it takes time to understand, accept and implement new ways of analysing transactions and other events. Nevertheless, establishing a goal towards which to strive is essential if financial reporting is to evolve so as to improve its usefulness.

Information about a reporting entity's economic resources, claims against the entity and changes in resources and claims

1.12 General purpose financial reports provide information about the financial position of a reporting entity, which is information about the entity's economic resources and the claims against the reporting entity. Financial reports also provide information about the effects of transactions and other events that change a reporting entity's economic resources and claims. Both types of information provide useful input for decisions relating to providing resources to an entity.

Economic resources and claims

1.13 Information about the nature and amounts of a reporting entity's economic resources and claims can help users to identify the reporting entity's financial strengths and weaknesses. That information can help users to assess the reporting entity's liquidity and solvency, its needs for additional financing and how successful it is likely to be in obtaining that financing. That information can also help users to assess management's stewardship of the entity's economic resources. Information about priorities and payment requirements of existing claims helps users to predict how future cash flows will be distributed among those with a claim against the reporting entity.

1.14 Different types of economic resources affect a user's assessment of the reporting entity's prospects for future cash flows differently. Some future cash flows result directly from existing economic resources, such as accounts receivable. Other cash flows result from using several resources in combination to produce and market goods or services to customers. Although those cash flows cannot be identified with individual economic resources (or claims), users of financial reports need to know the nature and amount of the resources available for use in a reporting entity's operations.

Changes in economic resources and claims

1.15 Changes in a reporting entity's economic resources and claims result from that entity's financial performance (see paragraphs 1.17–1.20) and from other events or transactions such as issuing debt or equity instruments (see paragraph 1.21). To properly assess both the prospects for future net cash inflows to the reporting entity and management's stewardship of the entity's economic resources, users need to be able to identify those two types of changes.

1.16 Information about a reporting entity's financial performance helps users to understand the return that the entity has produced on its economic resources. Information about the return the entity has produced can help users to assess management's stewardship of the entity's economic resources. Information about the variability and components of that return is also important, especially in assessing the uncertainty of future cash flows. Information about a reporting entity's past financial performance and how its management discharged its stewardship responsibilities is usually helpful in predicting the entity's future returns on its economic resources.

Financial performance reflected by accrual accounting

1.17 Accrual accounting depicts the effects of transactions and other events and circumstances on a reporting entity's economic resources and claims in the periods in which those effects occur, even if the resulting cash receipts and payments occur in a different period. This is important because information about a reporting entity's economic resources and claims and changes in its economic resources and claims during a period provides a better basis for assessing the entity's past and future performance than information solely about cash receipts and payments during that period.

1.18 Information about a reporting entity's financial performance during a period, reflected by changes in its economic resources and claims other than by obtaining additional resources directly from investors and creditors (see paragraph 1.21), is useful in assessing the entity's past and future ability to generate net cash inflows. That information indicates the extent to which the reporting entity has increased its available economic resources, and thus its capacity for generating net cash inflows through its operations rather than by obtaining additional resources directly from investors and creditors. Information about a reporting entity's financial performance during a period can also help users to assess management's stewardship of the entity's economic resources.

1.19 Information about a reporting entity's financial performance during a period may also indicate the extent to which events such as changes in market prices or interest rates have increased or decreased the entity's economic resources and claims, thereby affecting the entity's ability to generate net cash inflows.

Financial performance reflected by past cash flows

1.20 Information about a reporting entity's cash flows during a period also helps users to assess the entity's ability to generate future net cash inflows and to assess management's stewardship of the entity's economic resources. That information indicates how the reporting entity obtains and spends cash, including information about its borrowing and repayment of debt, cash dividends or other cash distributions to investors, and other factors that may affect the entity's liquidity or solvency. Information about cash flows helps users understand a reporting entity's operations, evaluate its financing and investing activities, assess its liquidity or solvency and interpret other information about financial performance.

Changes in economic resources and claims not resulting from financial performance

1.21 A reporting entity's economic resources and claims may also change for reasons other than financial performance, such as issuing debt or equity instruments. Information about this type of change is necessary to give users a complete understanding of why the reporting entity's economic resources and claims changed and the implications of those changes for its future financial performance.

Information about use of the entity's economic resources

1.22 Information about how efficiently and effectively the reporting entity's management has discharged its responsibilities to use the entity's economic resources helps users to assess management's stewardship of those resources. Such information is also useful for predicting how efficiently and effectively management will use the entity's economic resources in future periods. Hence, it can be useful for assessing the entity's prospects for future net cash inflows.

1.23 Examples of management's responsibilities to use the entity's economic resources include protecting those resources from unfavourable effects of economic factors, such as price and technological changes, and ensuring that the entity complies with applicable laws, regulations and contractual provisions.

from paragraph

CHAPTER 2—QUALITATIVE CHARACTERISTICS OF USEFUL FINANCIAL INFORMATION

Introduction

2.1 The qualitative characteristics of useful financial information discussed in this chapter identify the types of information that are likely to be most useful to the existing and potential investors, lenders and other creditors for making decisions about the reporting entity on the basis of information in its financial report (financial information).

2.2 Financial reports provide information about the reporting entity's economic resources, claims against the reporting entity and the effects of transactions and other events and conditions that change those resources and claims. (This information is referred to in the 2018 *NZ Conceptual Framework* as information about the economic phenomena.) Some financial reports also include explanatory material about management's expectations and strategies for the reporting entity, and other types of forward-looking information.

2.3 The qualitative characteristics of useful financial information[5] apply to financial information provided in financial statements, as well as to financial information provided in other ways. Cost, which is a pervasive constraint on the reporting entity's ability to provide useful financial information, applies similarly. However, the considerations in applying the qualitative characteristics and the cost constraint may be different for different types of information. For example, applying them to forward-looking information may be different from applying them to information about existing economic resources and claims and to changes in those resources and claims.

Qualitative characteristics of useful financial information

2.4 If financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable.

Fundamental qualitative characteristics

2.5 The fundamental qualitative characteristics are relevance and faithful representation.

Relevance

2.6 Relevant financial information is capable of making a difference in the decisions made by users. Information may be capable of making a difference in a decision even if some users choose not to take advantage of it or are already aware of it from other sources.

2.7 Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both.

2.8 Financial information has predictive value if it can be used as an input to processes employed by users to predict future outcomes. Financial information need not be a prediction or forecast to have predictive value. Financial information with predictive value is employed by users in making their own predictions.

2.9 Financial information has confirmatory value if it provides feedback about (confirms or changes) previous evaluations.

2.10 The predictive value and confirmatory value of financial information are interrelated. Information that has predictive value often also has confirmatory value. For example, revenue information for the current year, which can be used as the basis for predicting revenues in future years, can also be compared with revenue predictions for the current year that were made in past years. The results of those comparisons can help a user to correct and improve the processes that were used to make those previous predictions.

Materiality

2.11 Information is material if omitting it or misstating it could influence decisions that the primary users of general purpose financial reports (see paragraph 1.5) make on the basis of those reports, which provide

5 Throughout the 2018 *NZ Conceptual Framework*, the terms 'qualitative characteristics' and 'cost constraint' refer to the qualitative characteristics of, and the cost constraint on, useful financial information.

financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

Faithful representation

2.12 Financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent the substance of the phenomena that it purports to represent. In many circumstances, the substance of an economic phenomenon and its legal form are the same. If they are not the same, providing information only about the legal form would not faithfully represent the economic phenomenon (see paragraphs 4.59–4.62).

2.13 To be a perfectly faithful representation, a depiction would have three characteristics. It would be complete, neutral and free from error. Of course, perfection is seldom, if ever, achievable. The Board's objective is to maximise those qualities to the extent possible.

2.14 A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations. For example, a complete depiction of a group of assets would include, at a minimum, a description of the nature of the assets in the group, a numerical depiction of all of the assets in the group, and a description of what the numerical depiction represents (for example, historical cost or fair value). For some items, a complete depiction may also entail explanations of significant facts about the quality and nature of the items, factors and circumstances that might affect their quality and nature, and the process used to determine the numerical depiction.

2.15 A neutral depiction is without bias in the selection or presentation of financial information. A neutral depiction is not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to increase the probability that financial information will be received favourably or unfavourably by users. Neutral information does not mean information with no purpose or no influence on behaviour. On the contrary, relevant financial information is, by definition, capable of making a difference in users' decisions.

2.16 Neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgements under conditions of uncertainty. The exercise of prudence means that assets and income are not overstated and liabilities and expenses are not understated.[6] Equally, the exercise of prudence does not allow for the understatement of assets or income or the overstatement of liabilities or expenses. Such misstatements can lead to the overstatement or understatement of income or expenses in future periods.

2.17 The exercise of prudence does not imply a need for asymmetry, for example, a systematic need for more persuasive evidence to support the recognition of assets or income than the recognition of liabilities or expenses. Such asymmetry is not a qualitative characteristic of useful financial information. Nevertheless, particular Standards may contain asymmetric requirements if this is a consequence of decisions intended to select the most relevant information that faithfully represents what it purports to represent.

2.18 Faithful representation does not mean accurate in all respects. Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, free from error does not mean perfectly accurate in all respects. For example, an estimate of an unobservable price or value cannot be determined to be accurate or inaccurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process for developing the estimate.

2.19 When monetary amounts in financial reports cannot be observed directly and must instead be estimated, measurement uncertainty arises. The use of reasonable estimates is an essential part of the preparation of financial information and does not undermine the usefulness of the information if the estimates are clearly and accurately described and explained. Even a high level of measurement uncertainty does not necessarily prevent such an estimate from providing useful information (see paragraph 2.22).

Applying the fundamental qualitative characteristics

2.20 Information must both be relevant and provide a faithful representation of what it purports to represent if it is to be useful. Neither a faithful representation of an irrelevant phenomenon nor an unfaithful representation of a relevant phenomenon helps users make good decisions.

6 Assets, liabilities, income and expenses are defined in Table 4.1. They are the elements of financial statements.

2.21 The most efficient and effective process for applying the fundamental qualitative characteristics would usually be as follows (subject to the effects of enhancing characteristics and the cost constraint, which are not considered in this example). First, identify an economic phenomenon, information about which is capable of being useful to users of the reporting entity's financial information. Second, identify the type of information about that phenomenon that would be most relevant. Third, determine whether that information is available and whether it can provide a faithful representation of the economic phenomenon. If so, the process of satisfying the fundamental qualitative characteristics ends at that point. If not, the process is repeated with the next most relevant type of information.

2.22 In some cases, a trade-off between the fundamental qualitative characteristics may need to be made in order to meet the objective of financial reporting, which is to provide useful information about economic phenomena. For example, the most relevant information about a phenomenon may be a highly uncertain estimate. In some cases, the level of measurement uncertainty involved in making that estimate may be so high that it may be questionable whether the estimate would provide a sufficiently faithful representation of that phenomenon. In some such cases, the most useful information may be the highly uncertain estimate, accompanied by a description of the estimate and an explanation of the uncertainties that affect it. In other such cases, if that information would not provide a sufficiently faithful representation of that phenomenon, the most useful information may include an estimate of another type that is slightly less relevant but is subject to lower measurement uncertainty. In limited circumstances, there may be no estimate that provides useful information. In those limited circumstances, it may be necessary to provide information that does not rely on an estimate.

Enhancing qualitative characteristics

2.23 Comparability, verifiability, timeliness and understandability are qualitative characteristics that enhance the usefulness of information that both is relevant and provides a faithful representation of what it purports to represent. The enhancing qualitative characteristics may also help determine which of two ways should be used to depict a phenomenon if both are considered to provide equally relevant information and an equally faithful representation of that phenomenon.

Comparability

2.24 Users' decisions involve choosing between alternatives, for example, selling or holding an investment, or investing in one reporting entity or another. Consequently, information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date.

2.25 Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences among, items. Unlike the other qualitative characteristics, comparability does not relate to a single item. A comparison requires at least two items.

2.26 Consistency, although related to comparability, is not the same. Consistency refers to the use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities. Comparability is the goal; consistency helps to achieve that goal.

2.27 Comparability is not uniformity. For information to be comparable, like things must look alike and different things must look different. Comparability of financial information is not enhanced by making unlike things look alike any more than it is enhanced by making like things look different.

2.28 Some degree of comparability is likely to be attained by satisfying the fundamental qualitative characteristics. A faithful representation of a relevant economic phenomenon should naturally possess some degree of comparability with a faithful representation of a similar relevant economic phenomenon by another reporting entity.

2.29 Although a single economic phenomenon can be faithfully represented in multiple ways, permitting alternative accounting methods for the same economic phenomenon diminishes comparability.

Verifiability

2.30 Verifiability helps assure users that information faithfully represents the economic phenomena it purports to represent. Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. Quantified information need not be a single point estimate to be verifiable. A range of possible amounts and the related probabilities can also be verified.

2.31 Verification can be direct or indirect. Direct verification means verifying an amount or other representation through direct observation, for example, by counting cash. Indirect verification means checking the inputs to a model, formula or other technique and recalculating the outputs using the same methodology. An example is verifying the carrying amount of inventory by checking the inputs (quantities and costs) and recalculating the ending inventory using the same cost flow assumption (for example, using the first-in, first-out method).

2.32 It may not be possible to verify some explanations and forward-looking financial information until a future period, if at all. To help users decide whether they want to use that information, it would normally be necessary to disclose the underlying assumptions, the methods of compiling the information and other factors and circumstances that support the information.

Timeliness

2.33 Timeliness means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older the information is the less useful it is. However, some information may continue to be timely long after the end of a reporting period because, for example, some users may need to identify and assess trends.

Understandability

2.34 Classifying, characterising and presenting information clearly and concisely makes it understandable.

2.35 Some phenomena are inherently complex and cannot be made easy to understand. Excluding information about those phenomena from financial reports might make the information in those financial reports easier to understand. However, those reports would be incomplete and therefore possibly misleading.

2.36 Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.

Applying the enhancing qualitative characteristics

2.37 Enhancing qualitative characteristics should be maximised to the extent possible. However, the enhancing qualitative characteristics, either individually or as a group, cannot make information useful if that information is irrelevant or does not provide a faithful representation of what it purports to represent.

2.38 Applying the enhancing qualitative characteristics is an iterative process that does not follow a prescribed order. Sometimes, one enhancing qualitative characteristic may have to be diminished to maximise another qualitative characteristic. For example, a temporary reduction in comparability as a result of prospectively applying a new Standard may be worthwhile to improve relevance or faithful representation in the longer term. Appropriate disclosures may partially compensate for non-comparability.

The cost constraint on useful financial reporting

2.39 Cost is a pervasive constraint on the information that can be provided by financial reporting. Reporting financial information imposes costs, and it is important that those costs are justified by the benefits of reporting that information. There are several types of costs and benefits to consider.

2.40 Providers of financial information expend most of the effort involved in collecting, processing, verifying and disseminating financial information, but users ultimately bear those costs in the form of reduced returns. Users of financial information also incur costs of analysing and interpreting the information provided. If needed information is not provided, users incur additional costs to obtain that information elsewhere or to estimate it.

2.41 Reporting financial information that is relevant and faithfully represents what it purports to represent helps users to make decisions with more confidence. This results in more efficient functioning of capital markets and a lower cost of capital for the economy as a whole. An individual investor, lender or other creditor also receives benefits by making more informed decisions. However, it is not possible for general purpose financial reports to provide all the information that every user finds relevant.

2.42 In applying the cost constraint, the Board assesses whether the benefits of reporting particular information are likely to justify the costs incurred to provide and use that information. When applying the cost constraint in developing a proposed Standard, the Board seeks information from providers of financial information, users, auditors, academics and others about the expected nature and quantity of the benefits and costs of that Standard. In most situations, assessments are based on a combination of quantitative and qualitative information.

2.43 Because of the inherent subjectivity, different individuals' assessments of the costs and benefits of reporting particular items of financial information will vary. Therefore, the Board seeks to consider costs and benefits in relation to financial reporting generally, and not just in relation to individual reporting entities. That does not mean that assessments of costs and benefits always justify the same reporting requirements for all entities. Differences may be appropriate because of different sizes of entities, different ways of raising capital (publicly or privately), different users' needs or other factors.

from paragraph

CHAPTER 3—FINANCIAL STATEMENTS AND THE REPORTING ENTITY

Financial statements

3.1 Chapters 1 and 2 discuss information provided in general purpose financial reports and Chapters 3–8 discuss information provided in general purpose financial statements, which are a particular form of general purpose financial reports. Financial statements[7] provide information about economic resources of the reporting entity, claims against the entity, and changes in those resources and claims, that meet the definitions of the elements of financial statements (see Table 4.1).

Objective and scope of financial statements

3.2 The objective of financial statements is to provide financial information about the reporting entity's assets, liabilities, equity, income and expenses[8] that is useful to users of financial statements in assessing the prospects for future net cash inflows to the reporting entity and in assessing management's stewardship of the entity's economic resources (see paragraph 1.3).

3.3 That information is provided:

(a) in the statement of financial position, by recognising assets, liabilities and equity;

(b) in the statement(s) of financial performance,[9] by recognising income and expenses; and

(c) in other statements and notes, by presenting and disclosing information about:

(i) recognised assets, liabilities, equity, income and expenses (see paragraph 5.1), including information about their nature and about the risks arising from those recognised assets and liabilities;

(ii) assets and liabilities that have not been recognised (see paragraph 5.6), including information about their nature and about the risks arising from them;

(iii) cash flows;

(iv) contributions from holders of equity claims and distributions to them; and

(v) the methods, assumptions and judgements used in estimating the amounts presented or disclosed, and changes in those methods, assumptions and judgements.

Reporting period

3.4 Financial statements are prepared for a specified period of time (reporting period) and provide information about:

(a) assets and liabilities—including unrecognised assets and liabilities—and equity that existed at the end of the reporting period, or during the reporting period; and

(b) income and expenses for the reporting period.

3.5 To help users of financial statements to identify and assess changes and trends, financial statements also provide comparative information for at least one preceding reporting period.

3.6 Information about possible future transactions and other possible future events (forward-looking information) is included in financial statements if it:

(a) relates to the entity's assets or liabilities—including unrecognised assets or liabilities—or equity that existed at the end of the reporting period, or during the reporting period, or to income or expenses for the reporting period; and

(b) is useful to users of financial statements.

For example, if an asset or liability is measured by estimating future cash flows, information about those estimated future cash flows may help users of financial statements to understand the reported measures. Financial statements do not typically provide other types of forward-looking information, for example, explanatory material about management's expectations and strategies for the reporting entity.

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7 Throughout the 2018 *NZ Conceptual Framework*, the term 'financial statements' refers to general purpose financial statements.

8 Assets, liabilities, equity, income and expenses are defined in Table 4.1. They are the elements of financial statements.

9 The 2018 *NZ Conceptual Framework* does not specify whether the statement(s) of financial performance comprise(s) a single statement or two statements.

3.7 Financial statements include information about transactions and other events that have occurred after the end of the reporting period if providing that information is necessary to meet the objective of financial statements (see paragraph 3.2).

Perspective adopted in financial statements

3.8 Financial statements provide information about transactions and other events viewed from the perspective of the reporting entity as a whole, not from the perspective of any particular group of the entity's existing or potential investors, lenders or other creditors.

Going concern assumption

3.9 Financial statements are normally prepared on the assumption that the reporting entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to enter liquidation or to cease trading. If such an intention or need exists, the financial statements may have to be prepared on a different basis. If so, the financial statements describe the basis used.

The reporting entity

3.10 A reporting entity is an entity that is required, or chooses, to prepare financial statements. A reporting entity can be a single entity or a portion of an entity or can comprise more than one entity. A reporting entity is not necessarily a legal entity.

3.11 Sometimes one entity (parent) has control over another entity (subsidiary). If a reporting entity comprises both the parent and its subsidiaries, the reporting entity's financial statements are referred to as 'consolidated financial statements' (see paragraphs 3.15–3.16). If a reporting entity is the parent alone, the reporting entity's financial statements are referred to as 'unconsolidated financial statements' (see paragraphs 3.17–3.18).

3.12 If a reporting entity comprises two or more entities that are not all linked by a parent-subsidiary relationship, the reporting entity's financial statements are referred to as 'combined financial statements'.

3.13 Determining the appropriate boundary of a reporting entity can be difficult if the reporting entity:

(a) is not a legal entity; and

(b) does not comprise only legal entities linked by a parent-subsidiary relationship.

3.14 In such cases, determining the boundary of the reporting entity is driven by the information needs of the primary users of the reporting entity's financial statements. Those users need relevant information that faithfully represents what it purports to represent. Faithful representation requires that:

(a) the boundary of the reporting entity does not contain an arbitrary or incomplete set of economic activities;

(b) including that set of economic activities within the boundary of the reporting entity results in neutral information; and

(c) a description is provided of how the boundary of the reporting entity was determined and of what constitutes the reporting entity.

Consolidated and unconsolidated financial statements

3.15 Consolidated financial statements provide information about the assets, liabilities, equity, income and expenses of both the parent and its subsidiaries as a single reporting entity. That information is useful for existing and potential investors, lenders and other creditors of the parent in their assessment of the prospects for future net cash inflows to the parent. This is because net cash inflows to the parent include distributions to the parent from its subsidiaries, and those distributions depend on net cash inflows to the subsidiaries.

3.16 Consolidated financial statements are not designed to provide separate information about the assets, liabilities, equity, income and expenses of any particular subsidiary. A subsidiary's own financial statements are designed to provide that information.

3.17 Unconsolidated financial statements are designed to provide information about the parent's assets, liabilities, equity, income and expenses, and not about those of its subsidiaries. That information can be useful to existing and potential investors, lenders and other creditors of the parent because:

(a) a claim against the parent typically does not give the holder of that claim a claim against subsidiaries; and

(b) in some jurisdictions, the amounts that can be legally distributed to holders of equity claims against the parent depend on the distributable reserves of the parent.

Another way to provide information about some or all assets, liabilities, equity, income and expenses of the parent alone is in consolidated financial statements, in the notes.

3.18 Information provided in unconsolidated financial statements is typically not sufficient to meet the information needs of existing and potential investors, lenders and other creditors of the parent. Accordingly, when consolidated financial statements are required, unconsolidated financial statements cannot serve as a substitute for consolidated financial statements. Nevertheless, a parent may be required, or choose, to prepare unconsolidated financial statements in addition to consolidated financial statements.

from paragraph

CHAPTER 4—THE ELEMENTS OF FINANCIAL STATEMENTS

Introduction

4.1 The elements of financial statements defined in the 2018 *NZ Conceptual Framework* are:

(a) assets, liabilities and equity, which relate to a reporting entity's financial position; and

(b) income and expenses, which relate to a reporting entity's financial performance.

4.2 Those elements are linked to the economic resources, claims and changes in economic resources and claims discussed in Chapter 1, and are defined in Table 4.1.

Table 4.1—The elements of financial statements

Item discussed in Chapter 1	Element	Definition or description
Economic resource	Asset	A present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits.
Claim	Liability	A present obligation of the entity to transfer an economic resource as a result of past events.
	Equity	The residual interest in the assets of the entity after deducting all its liabilities.
Changes in economic resources and claims, reflecting financial performance	Income	Increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.
	Expenses	Decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.
Other changes in economic resources and claims	–	Contributions from holders of equity claims, and distributions to them.
	–	Exchanges of assets or liabilities that do not result in increases or decreases in equity.

Definition of an asset

4.3 An asset is a present economic resource controlled by the entity as a result of past events.

4.4 An economic resource is a right that has the potential to produce economic benefits.

4.5 This section discusses three aspects of those definitions:

(a) right (see paragraphs 4.6–4.13);

(b) potential to produce economic benefits (see paragraphs 4.14–4.18); and

(c) control (see paragraphs 4.19–4.25).

Right

4.6 Rights that have the potential to produce economic benefits take many forms, including:

(a) rights that correspond to an obligation of another party (see paragraph 4.39), for example:

(i) rights to receive cash.

(ii) rights to receive goods or services.

(iii) rights to exchange economic resources with another party on favourable terms. Such rights include, for example, a forward contract to buy an economic resource on terms that are currently favourable or an option to buy an economic resource.

(iv) rights to benefit from an obligation of another party to transfer an economic resource if a specified uncertain future event occurs (see paragraph 4.37).

(b) rights that do not correspond to an obligation of another party, for example:

(i) rights over physical objects, such as property, plant and equipment or inventories. Examples of such rights are a right to use a physical object or a right to benefit from the residual value of a leased object.

(ii) rights to use intellectual property.

4.7 Many rights are established by contract, legislation or similar means. For example, an entity might obtain rights from owning or leasing a physical object, from owning a debt instrument or an equity instrument, or from owning a registered patent. However, an entity might also obtain rights in other ways, for example:

(a) by acquiring or creating know-how that is not in the public domain (see paragraph 4.22); or

(b) through an obligation of another party that arises because that other party has no practical ability to act in a manner inconsistent with its customary practices, published policies or specific statements (see paragraph 4.31).

4.8 Some goods or services—for example, employee services—are received and immediately consumed. An entity's right to obtain the economic benefits produced by such goods or services exists momentarily until the entity consumes the goods or services.

4.9 Not all of an entity's rights are assets of that entity—to be assets of the entity, the rights must both have the potential to produce for the entity economic benefits beyond the economic benefits available to all other parties (see paragraphs 4.14–4.18) and be controlled by the entity (see paragraphs 4.19–4.25). For example, rights available to all parties without significant cost—for instance, rights of access to public goods, such as public rights of way over land, or know-how that is in the public domain—are typically not assets for the entities that hold them.

4.10 An entity cannot have a right to obtain economic benefits from itself. Hence:

(a) debt instruments or equity instruments issued by the entity and repurchased and held by it—for example, treasury shares—are not economic resources of that entity; and

(b) if a reporting entity comprises more than one legal entity, debt instruments or equity instruments issued by one of those legal entities and held by another of those legal entities are not economic resources of the reporting entity.

4.11 In principle, each of an entity's rights is a separate asset. However, for accounting purposes, related rights are often treated as a single unit of account that is a single asset (see paragraphs 4.48–4.55). For example, legal ownership of a physical object may give rise to several rights, including:

(a) the right to use the object;

(b) the right to sell rights over the object;

(c) the right to pledge rights over the object; and

(d) other rights not listed in (a)–(c).

4.12 In many cases, the set of rights arising from legal ownership of a physical object is accounted for as a single asset. Conceptually, the economic resource is the set of rights, not the physical object. Nevertheless, describing the set of rights as the physical object will often provide a faithful representation of those rights in the most concise and understandable way.

4.13 In some cases, it is uncertain whether a right exists. For example, an entity and another party might dispute whether the entity has a right to receive an economic resource from that other party. Until that existence uncertainty is resolved—for example, by a court ruling—it is uncertain whether the entity has a right and, consequently, whether an asset exists. (Paragraph 5.14 discusses recognition of assets whose existence is uncertain.)

Potential to produce economic benefits

4.14 An economic resource is a right that has the potential to produce economic benefits. For that potential to exist, it does not need to be certain, or even likely, that the right will produce economic benefits. It is only necessary that the right already exists and that, in at least one circumstance, it would produce for the entity economic benefits beyond those available to all other parties.

4.15 A right can meet the definition of an economic resource, and hence can be an asset, even if the probability that it will produce economic benefits is low. Nevertheless, that low probability might affect decisions about what information to provide about the asset and how to provide that information, including decisions about whether the asset is recognised (see paragraphs 5.15–5.17) and how it is measured.

4.16 An economic resource could produce economic benefits for an entity by entitling or enabling it to do, for example, one or more of the following:

(a) receive contractual cash flows or another economic resource;

(b) exchange economic resources with another party on favourable terms;

(c) produce cash inflows or avoid cash outflows by, for example:

  (i) using the economic resource either individually or in combination with other economic resources to produce goods or provide services;

  (ii) using the economic resource to enhance the value of other economic resources; or

  (iii) leasing the economic resource to another party;

(d) receive cash or other economic resources by selling the economic resource; or

(e) extinguish liabilities by transferring the economic resource.

4.17 Although an economic resource derives its value from its present potential to produce future economic benefits, the economic resource is the present right that contains that potential, not the future economic benefits that the right may produce. For example, a purchased option derives its value from its potential to produce economic benefits through exercise of the option at a future date. However, the economic resource is the present right—the right to exercise the option at a future date. The economic resource is not the future economic benefits that the holder will receive if the option is exercised.

4.18 There is a close association between incurring expenditure and acquiring assets, but the two do not necessarily coincide. Hence, when an entity incurs expenditure, this may provide evidence that the entity has sought future economic benefits, but does not provide conclusive proof that the entity has obtained an asset. Similarly, the absence of related expenditure does not preclude an item from meeting the definition of an asset. Assets can include, for example, rights that a government has granted to the entity free of charge or that another party has donated to the entity.

Control

4.19 Control links an economic resource to an entity. Assessing whether control exists helps to identify the economic resource for which the entity accounts. For example, an entity may control a proportionate share in a property without controlling the rights arising from ownership of the entire property. In such cases, the entity's asset is the share in the property, which it controls, not the rights arising from ownership of the entire property, which it does not control.

4.20 An entity controls an economic resource if it has the present ability to direct the use of the economic resource and obtain the economic benefits that may flow from it. Control includes the present ability to prevent other parties from directing the use of the economic resource and from obtaining the economic benefits that may flow from it. It follows that, if one party controls an economic resource, no other party controls that resource.

4.21 An entity has the present ability to direct the use of an economic resource if it has the right to deploy that economic resource in its activities, or to allow another party to deploy the economic resource in that other party's activities.

4.22 Control of an economic resource usually arises from an ability to enforce legal rights. However, control can also arise if an entity has other means of ensuring that it, and no other party, has the present ability to direct the use of the economic resource and obtain the benefits that may flow from it. For example, an entity could control a right to use know-how that is not in the public domain if the entity has access to the know-how and the present ability to keep the know-how secret, even if that know-how is not protected by a registered patent.

4.23 For an entity to control an economic resource, the future economic benefits from that resource must flow to the entity either directly or indirectly rather than to another party. This aspect of control does not imply that the entity can ensure that the resource will produce economic benefits in all circumstances. Instead, it means that if the resource produces economic benefits, the entity is the party that will obtain them either directly or indirectly.

4.24 Having exposure to significant variations in the amount of the economic benefits produced by an economic resource may indicate that the entity controls the resource. However, it is only one factor to consider in the overall assessment of whether control exists.

4.25 Sometimes one party (a principal) engages another party (an agent) to act on behalf of, and for the benefit of, the principal. For example, a principal may engage an agent to arrange sales of goods controlled by the principal. If an agent has custody of an economic resource controlled by the principal, that economic resource is not an asset of the agent. Furthermore, if the agent has an obligation to transfer to a third party an economic resource controlled by the principal, that obligation is not a liability of the agent, because the economic resource that would be transferred is the principal's economic resource, not the agent's.

Definition of a liability

4.26 A liability is a present obligation of the entity to transfer an economic resource as a result of past events.

4.27 For a liability to exist, three criteria must all be satisfied:

(a) the entity has an obligation (see paragraphs 4.28–4.35);

(b) the obligation is to transfer an economic resource (see paragraphs 4.36–4.41); and

(c) the obligation is a present obligation that exists as a result of past events (see paragraphs 4.42–4.47).

Obligation

4.28 The first criterion for a liability is that the entity has an obligation.

4.29 An obligation is a duty or responsibility that an entity has no practical ability to avoid. An obligation is always owed to another party (or parties). The other party (or parties) could be a person or another entity, a group of people or other entities, or society at large. It is not necessary to know the identity of the party (or parties) to whom the obligation is owed.

4.30 If one party has an obligation to transfer an economic resource, it follows that another party (or parties) has a right to receive that economic resource. However, a requirement for one party to recognise a liability and measure it at a specified amount does not imply that the other party (or parties) must recognise an asset or measure it at the same amount. For example, particular Standards may contain different recognition criteria or measurement requirements for the liability of one party and the corresponding asset of the other party (or parties) if those different criteria or requirements are a consequence of decisions intended to select the most relevant information that faithfully represents what it purports to represent.

4.31 Many obligations are established by contract, legislation or similar means and are legally enforceable by the party (or parties) to whom they are owed. Obligations can also arise, however, from an entity's customary practices, published policies or specific statements if the entity has no practical ability to act in a manner inconsistent with those practices, policies or statements. The obligation that arises in such situations is sometimes referred to as a 'constructive obligation'.

4.32 In some situations, an entity's duty or responsibility to transfer an economic resource is conditional on a particular future action that the entity itself may take. Such actions could include operating a particular business or operating in a particular market on a specified future date, or exercising particular options within a contract. In such situations, the entity has an obligation if it has no practical ability to avoid taking that action.

4.33 A conclusion that it is appropriate to prepare an entity's financial statements on a going concern basis also implies a conclusion that the entity has no practical ability to avoid a transfer that could be avoided only by liquidating the entity or by ceasing to trade.

4.34 The factors used to assess whether an entity has the practical ability to avoid transferring an economic resource may depend on the nature of the entity's duty or responsibility. For example, in some cases, an entity may have no practical ability to avoid a transfer if any action that it could take to avoid the transfer would have economic consequences significantly more adverse than the transfer itself. However, neither an intention to make a transfer, nor a high likelihood of a transfer, is sufficient reason for concluding that the entity has no practical ability to avoid a transfer.

4.35 In some cases, it is uncertain whether an obligation exists. For example, if another party is seeking compensation for an entity's alleged act of wrongdoing, it might be uncertain whether the act occurred, whether the entity committed it or how the law applies. Until that existence uncertainty is resolved—for example, by a court ruling—it is uncertain whether the entity has an obligation to the party seeking compensation and, consequently, whether a liability exists. (Paragraph 5.14 discusses recognition of liabilities whose existence is uncertain.)

Transfer of an economic resource

4.36 The second criterion for a liability is that the obligation is to transfer an economic resource.

4.37 To satisfy this criterion, the obligation must have the potential to require the entity to transfer an economic resource to another party (or parties). For that potential to exist, it does not need to be certain, or even likely, that the entity will be required to transfer an economic resource—the transfer may, for example, be required only if a specified uncertain future event occurs. It is only necessary that the obligation already exists and that, in at least one circumstance, it would require the entity to transfer an economic resource.

4.38 An obligation can meet the definition of a liability even if the probability of a transfer of an economic resource is low. Nevertheless, that low probability might affect decisions about what information to provide about the liability and how to provide that information, including decisions about whether the liability is recognised (see paragraphs 5.15–5.17) and how it is measured.

4.39 Obligations to transfer an economic resource include, for example:

(a) obligations to pay cash.

(b) obligations to deliver goods or provide services.

(c) obligations to exchange economic resources with another party on unfavourable terms. Such obligations include, for example, a forward contract to sell an economic resource on terms that are currently unfavourable or an option that entitles another party to buy an economic resource from the entity.

(d) obligations to transfer an economic resource if a specified uncertain future event occurs.

(e) obligations to issue a financial instrument if that financial instrument will oblige the entity to transfer an economic resource.

4.40 Instead of fulfilling an obligation to transfer an economic resource to the party that has a right to receive that resource, entities sometimes decide to, for example:

(a) settle the obligation by negotiating a release from the obligation;

(b) transfer the obligation to a third party; or

(c) replace that obligation to transfer an economic resource with another obligation by entering into a new transaction.

4.41 In the situations described in paragraph 4.40, an entity has the obligation to transfer an economic resource until it has settled, transferred or replaced that obligation.

Present obligation as a result of past events

4.42 The third criterion for a liability is that the obligation is a present obligation that exists as a result of past events.

4.43 A present obligation exists as a result of past events only if:

(a) the entity has already obtained economic benefits or taken an action; and

(b) as a consequence, the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer.

4.44 The economic benefits obtained could include, for example, goods or services. The action taken could include, for example, operating a particular business or operating in a particular market. If economic benefits are obtained, or an action is taken, over time, the resulting present obligation may accumulate over that time.

4.45 If new legislation is enacted, a present obligation arises only when, as a consequence of obtaining economic benefits or taking an action to which that legislation applies, an entity will or may have to transfer an economic resource that it would not otherwise have had to transfer. The enactment of legislation is not in itself sufficient to give an entity a present obligation. Similarly, an entity's customary practice, published policy or specific statement of the type mentioned in paragraph 4.31 gives rise to a present obligation only when, as a consequence of obtaining economic benefits, or taking an action, to which that practice, policy or statement applies, the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer.

4.46 A present obligation can exist even if a transfer of economic resources cannot be enforced until some point in the future. For example, a contractual liability to pay cash may exist now even if the contract does not require a payment until a future date. Similarly, a contractual obligation for an entity to perform work at a future date may exist now even if the counterparty cannot require the entity to perform the work until that future date.

4.47 An entity does not yet have a present obligation to transfer an economic resource if it has not yet satisfied the criteria in paragraph 4.43, that is, if it has not yet obtained economic benefits, or taken an action, that would or could require the entity to transfer an economic resource that it would not otherwise have had to transfer. For example, if an entity has entered into a contract to pay an employee a salary in exchange for receiving the employee's services, the entity does not have a present obligation to pay the salary until it has received the employee's services. Before then the contract is executory—the entity has a combined right and obligation to exchange future salary for future employee services (see paragraphs 4.56–4.58).

Assets and liabilities

Unit of account

4.48 The unit of account is the right or the group of rights, the obligation or the group of obligations, or the group of rights and obligations, to which recognition criteria and measurement concepts are applied.

4.49 A unit of account is selected for an asset or liability when considering how recognition criteria and measurement concepts will apply to that asset or liability and to the related income and expenses. In some circumstances, it may be appropriate to select one unit of account for recognition and a different unit of account for measurement. For example, contracts may sometimes be recognised individually but measured as part of a portfolio of contracts. For presentation and disclosure, assets, liabilities, income and expenses may need to be aggregated or separated into components.

4.50 If an entity transfers part of an asset or part of a liability, the unit of account may change at that time, so that the transferred component and the retained component become separate units of account (see paragraphs 5.26–5.33).

4.51 A unit of account is selected to provide useful information, which implies that:

(a) the information provided about the asset or liability and about any related income and expenses must be relevant. Treating a group of rights and obligations as a single unit of account may provide more relevant information than treating each right or obligation as a separate unit of account if, for example, those rights and obligations:

- (i) cannot be or are unlikely to be the subject of separate transactions;
- (ii) cannot or are unlikely to expire in different patterns;
- (iii) have similar economic characteristics and risks and hence are likely to have similar implications for the prospects for future net cash inflows to the entity or net cash outflows from the entity; or
- (iv) are used together in the business activities conducted by an entity to produce cash flows and are measured by reference to estimates of their interdependent future cash flows.

(b) the information provided about the asset or liability and about any related income and expenses must faithfully represent the substance of the transaction or other event from which they have arisen. Therefore, it may be necessary to treat rights or obligations arising from different sources as a single unit of account, or to separate the rights or obligations arising from a single source (see paragraph 4.62). Equally, to provide a faithful representation of unrelated rights and obligations, it may be necessary to recognise and measure them separately.

4.52 Just as cost constrains other financial reporting decisions, it also constrains the selection of a unit of account. Hence, in selecting a unit of account, it is important to consider whether the benefits of the information provided to users of financial statements by selecting that unit of account are likely to justify the costs of providing and using that information. In general, the costs associated with recognising and measuring assets, liabilities, income and expenses increase as the size of the unit of account decreases. Hence, in general, rights or obligations arising from the same source are separated only if the resulting information is more useful and the benefits outweigh the costs.

4.53 Sometimes, both rights and obligations arise from the same source. For example, some contracts establish both rights and obligations for each of the parties. If those rights and obligations are interdependent and cannot be separated, they constitute a single inseparable asset or liability and hence form a single unit of account. For example, this is the case with executory contracts (see paragraph 4.57). Conversely, if rights are separable from obligations, it may sometimes be appropriate to group the rights separately from the obligations, resulting in the identification of one or more separate assets and liabilities. In other cases, it may be more appropriate to group separable rights and obligations in a single unit of account treating them as a single asset or a single liability.

4.54 Treating a set of rights and obligations as a single unit of account differs from offsetting assets and liabilities (see paragraph 7.10).

4.55 Possible units of account include:

(a) an individual right or individual obligation;

(b) all rights, all obligations, or all rights and all obligations, arising from a single source, for example, a contract;

(c) a subgroup of those rights and/or obligations—for example, a subgroup of rights over an item of property, plant and equipment for which the useful life and pattern of consumption differ from those of the other rights over that item;

(d) a group of rights and/or obligations arising from a portfolio of similar items;

(e) a group of rights and/or obligations arising from a portfolio of dissimilar items—for example, a portfolio of assets and liabilities to be disposed of in a single transaction; and

(f) a risk exposure within a portfolio of items—if a portfolio of items is subject to a common risk, some aspects of the accounting for that portfolio could focus on the aggregate exposure to that risk within the portfolio.

Executory contracts

4.56 An executory contract is a contract, or a portion of a contract, that is equally unperformed—neither party has fulfilled any of its obligations, or both parties have partially fulfilled their obligations to an equal extent.

4.57 An executory contract establishes a combined right and obligation to exchange economic resources. The right and obligation are interdependent and cannot be separated. Hence, the combined right and obligation constitute a single asset or liability. The entity has an asset if the terms of the exchange are currently favourable; it has a liability if the terms of the exchange are currently unfavourable. Whether such an asset or liability is included in the financial statements depends on both the recognition criteria (see Chapter 5) and the measurement basis (see Chapter 6) selected for the asset or liability, including, if applicable, any test for whether the contract is onerous.

4.58 To the extent that either party fulfils its obligations under the contract, the contract is no longer executory. If the reporting entity performs first under the contract, that performance is the event that changes the reporting entity's right and obligation to exchange economic resources into a right to receive an economic resource. That right is an asset. If the other party performs first, that performance is the event that changes the reporting entity's right and obligation to exchange economic resources into an obligation to transfer an economic resource. That obligation is a liability.

Substance of contractual rights and contractual obligations

4.59 The terms of a contract create rights and obligations for an entity that is a party to that contract. To represent those rights and obligations faithfully, financial statements report their substance (see paragraph 2.12). In some cases, the substance of the rights and obligations is clear from the legal form of the contract. In other cases, the terms of the contract or a group or series of contracts require analysis to identify the substance of the rights and obligations.

4.60 All terms in a contract—whether explicit or implicit—are considered unless they have no substance. Implicit terms could include, for example, obligations imposed by statute, such as statutory warranty obligations imposed on entities that enter into contracts to sell goods to customers.

4.61 Terms that have no substance are disregarded. A term has no substance if it has no discernible effect on the economics of the contract. Terms that have no substance could include, for example:

(a) terms that bind neither party; or

(b) rights, including options, that the holder will not have the practical ability to exercise in any circumstances.

4.62 A group or series of contracts may achieve or be designed to achieve an overall commercial effect. To report the substance of such contracts, it may be necessary to treat rights and obligations arising from that group or series of contracts as a single unit of account. For example, if the rights or obligations in one contract merely nullify all the rights or obligations in another contract entered into at the same time with the same counterparty, the combined effect is that the two contracts create no rights or obligations. Conversely, if a single contract creates two or more sets of rights or obligations that could have been created through two or more separate contracts, an entity may need to account for each set as if it arose from separate contracts in order to faithfully represent the rights and obligations (see paragraphs 4.48–4.55).

Definition of equity

4.63 Equity is the residual interest in the assets of the entity after deducting all its liabilities.

4.64 Equity claims are claims on the residual interest in the assets of the entity after deducting all its liabilities. In other words, they are claims against the entity that do not meet the definition of a liability. Such claims may be established by contract, legislation or similar means, and include, to the extent that they do not meet the definition of a liability:

(a) shares of various types, issued by the entity; and

(b) some obligations of the entity to issue another equity claim.

4.65 Different classes of equity claims, such as ordinary shares and preference shares, may confer on their holders different rights, for example, rights to receive some or all of the following from the entity:

(a) dividends, if the entity decides to pay dividends to eligible holders;

(b) the proceeds from satisfying the equity claims, either in full on liquidation, or in part at other times; or

(c) other equity claims.

4.66 Sometimes, legal, regulatory or other requirements affect particular components of equity, such as share capital or retained earnings. For example, some such requirements permit an entity to make distributions to holders of equity claims only if the entity has sufficient reserves that those requirements specify as being distributable.

4.67 Business activities are often undertaken by entities such as sole proprietorships, partnerships, trusts or various types of government business undertakings. The legal and regulatory frameworks for such entities are often different from frameworks that apply to corporate entities. For example, there may be few, if any, restrictions on the distribution to holders of equity claims against such entities. Nevertheless, the definition of equity in paragraph 4.63 of the 2018 *NZ Conceptual Framework* applies to all reporting entities.

Definitions of income and expenses

4.68 Income is increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.

4.69 Expenses are decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.

4.70 It follows from these definitions of income and expenses that contributions from holders of equity claims are not income, and distributions to holders of equity claims are not expenses.

4.71 Income and expenses are the elements of financial statements that relate to an entity's financial performance. Users of financial statements need information about both an entity's financial position and its financial performance. Hence, although income and expenses are defined in terms of changes in assets and liabilities, information about income and expenses is just as important as information about assets and liabilities.

4.72 Different transactions and other events generate income and expenses with different characteristics. Providing information separately about income and expenses with different characteristics can help users of financial statements to understand the entity's financial performance (see paragraphs 7.14–7.19).

from paragraph

CHAPTER 5—RECOGNITION AND DERECOGNITION

The recognition process

5.1 Recognition is the process of capturing for inclusion in the statement of financial position or the statement(s) of financial performance an item that meets the definition of one of the elements of financial statements—an asset, a liability, equity, income or expenses. Recognition involves depicting the item in one of those statements—either alone or in aggregation with other items—in words and by a monetary amount, and including that amount in one or more totals in that statement. The amount at which an asset, a liability or equity is recognised in the statement of financial position is referred to as its 'carrying amount'.

5.2 The statement of financial position and statement(s) of financial performance depict an entity's recognised assets, liabilities, equity, income and expenses in structured summaries that are designed to make financial information comparable and understandable. An important feature of the structures of those summaries is that the amounts recognised in a statement are included in the totals and, if applicable, subtotals that link the items recognised in the statement.

5.3 Recognition links the elements, the statement of financial position and the statement(s) of financial performance as follows (see Diagram 5.1):

(a) in the statement of financial position at the beginning and end of the reporting period, total assets minus total liabilities equal total equity; and

(b) recognised changes in equity during the reporting period comprise:

(i) income minus expenses recognised in the statement(s) of financial performance; plus

(ii) contributions from holders of equity claims, minus distributions to holders of equity claims.

5.4 The statements are linked because the recognition of one item (or a change in its carrying amount) requires the recognition or derecognition of one or more other items (or changes in the carrying amount of one or more other items). For example:

(a) the recognition of income occurs at the same time as:

(i) the initial recognition of an asset, or an increase in the carrying amount of an asset; or

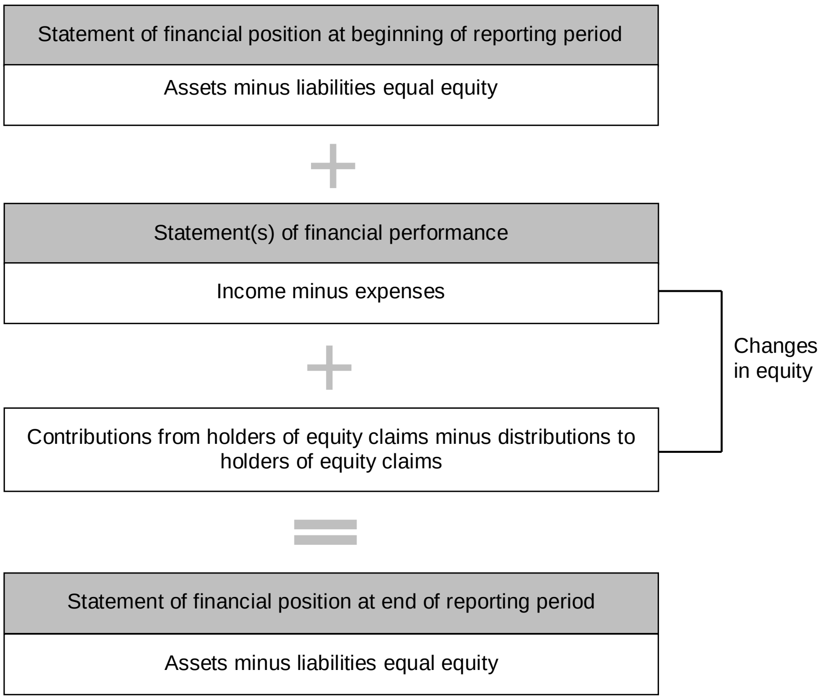
(ii) the derecognition of a liability, or a decrease in the carrying amount of a liability.

(b) the recognition of expenses occurs at the same time as:

(i) the initial recognition of a liability, or an increase in the carrying amount of a liability; or

(ii) the derecognition of an asset, or a decrease in the carrying amount of an asset.

Diagram 5.1: How recognition links the elements of financial statements



5.5 The initial recognition of assets or liabilities arising from transactions or other events may result in the simultaneous recognition of both income and related expenses. For example, the sale of goods for cash results in the recognition of both income (from the recognition of one asset—the cash) and an expense (from the derecognition of another asset—the goods sold). The simultaneous recognition of income and related expenses is sometimes referred to as the matching of costs with income. Application of the concepts in the 2018 *NZ Conceptual Framework* leads to such matching when it arises from the recognition of changes in assets and liabilities. However, matching of costs with income is not an objective of the 2018 *NZ Conceptual Framework*. The 2018 *NZ Conceptual Framework* does not allow the recognition in the statement of financial position of items that do not meet the definition of an asset, a liability or equity.

Recognition criteria

5.6 Only items that meet the definition of an asset, a liability or equity are recognised in the statement of financial position. Similarly, only items that meet the definition of income or expenses are recognised in the statement(s) of financial performance. However, not all items that meet the definition of one of those elements are recognised.

5.7 Not recognising an item that meets the definition of one of the elements makes the statement of financial position and the statement(s) of financial performance less complete and can exclude useful information from financial statements. On the other hand, in some circumstances, recognising some items that meet the definition of one of the elements would not provide useful information. An asset or liability is recognised only if recognition of that asset or liability and of any resulting income, expenses or changes in equity provides users of financial statements with information that is useful, ie with:

(a) relevant information about the asset or liability and about any resulting income, expenses or changes in equity (see paragraphs 5.12–5.17); and

(b) a faithful representation of the asset or liability and of any resulting income, expenses or changes in equity (see paragraphs 5.18–5.25).

5.8 Just as cost constrains other financial reporting decisions, it also constrains recognition decisions. There is a cost to recognising an asset or liability. Preparers of financial statements incur costs in obtaining a relevant measure of an asset or liability. Users of financial statements also incur costs in analysing and interpreting the information provided. An asset or liability is recognised if the benefits of the information provided to users of financial statements by recognition are likely to justify the costs of providing and using that information. In some cases, the costs of recognition may outweigh its benefits.

5.9 It is not possible to define precisely when recognition of an asset or liability will provide useful information to users of financial statements, at a cost that does not outweigh its benefits. What is useful to users depends on the item and the facts and circumstances. Consequently, judgement is required when deciding whether to recognise an item, and thus recognition requirements may need to vary between and within Standards.

5.10 It is important when making decisions about recognition to consider the information that would be given if an asset or liability were not recognised. For example, if no asset is recognised when expenditure is incurred, an expense is recognised. Over time, recognising the expense may, in some cases, provide useful information, for example, information that enables users of financial statements to identify trends.

5.11 Even if an item meeting the definition of an asset or liability is not recognised, an entity may need to provide information about that item in the notes. It is important to consider how to make such information sufficiently visible to compensate for the item's absence from the structured summary provided by the statement of financial position and, if applicable, the statement(s) of financial performance.

Relevance

5.12 Information about assets, liabilities, equity, income and expenses is relevant to users of financial statements. However, recognition of a particular asset or liability and any resulting income, expenses or changes in equity may not always provide relevant information. That may be the case if, for example:

(a) it is uncertain whether an asset or liability exists (see paragraph 5.14); or

(b) an asset or liability exists, but the probability of an inflow or outflow of economic benefits is low (see paragraphs 5.15–5.17).

5.13 The presence of one or both of the factors described in paragraph 5.12 does not lead automatically to a conclusion that the information provided by recognition lacks relevance. Moreover, factors other than those described in paragraph 5.12 may also affect the conclusion. It may be a combination of factors and not any single factor that determines whether recognition provides relevant information.

Existence uncertainty

5.14 Paragraphs 4.13 and 4.35 discuss cases in which it is uncertain whether an asset or liability exists. In some cases, that uncertainty, possibly combined with a low probability of inflows or outflows of economic benefits and an exceptionally wide range of possible outcomes, may mean that the recognition of an asset or liability, necessarily measured at a single amount, would not provide relevant information. Whether or not the asset or liability is recognised, explanatory information about the uncertainties associated with it may need to be provided in the financial statements.

Low probability of an inflow or outflow of economic benefits

5.15 An asset or liability can exist even if the probability of an inflow or outflow of economic benefits is low (see paragraphs 4.15 and 4.38).

5.16 If the probability of an inflow or outflow of economic benefits is low, the most relevant information about the asset or liability may be information about the magnitude of the possible inflows or outflows, their possible timing and the factors affecting the probability of their occurrence. The typical location for such information is in the notes.

5.17 Even if the probability of an inflow or outflow of economic benefits is low, recognition of the asset or liability may provide relevant information beyond the information described in paragraph 5.16. Whether that is the case may depend on a variety of factors. For example:

(a) if an asset is acquired or a liability is incurred in an exchange transaction on market terms, its cost generally reflects the probability of an inflow or outflow of economic benefits. Thus, that cost may be relevant information, and is generally readily available. Furthermore, not recognising the asset or liability would result in the recognition of expenses or income at the time of the exchange, which might not be a faithful representation of the transaction (see paragraph 5.25(a)).

(b) if an asset or liability arises from an event that is not an exchange transaction, recognition of the asset or liability typically results in recognition of income or expenses. If there is only a low probability that the asset or liability will result in an inflow or outflow of economic benefits, users of financial statements might not regard the recognition of the asset and income, or the liability and expenses, as providing relevant information.

Faithful representation

5.18 Recognition of a particular asset or liability is appropriate if it provides not only relevant information, but also a faithful representation of that asset or liability and of any resulting income, expenses or changes in equity. Whether a faithful representation can be provided may be affected by the level of measurement uncertainty associated with the asset or liability or by other factors.

Measurement uncertainty

5.19 For an asset or liability to be recognised, it must be measured. In many cases, such measures must be estimated and are therefore subject to measurement uncertainty. As noted in paragraph 2.19, the use of reasonable estimates is an essential part of the preparation of financial information and does not undermine the usefulness of the information if the estimates are clearly and accurately described and explained. Even a high level of measurement uncertainty does not necessarily prevent such an estimate from providing useful information.

5.20 In some cases, the level of uncertainty involved in estimating a measure of an asset or liability may be so high that it may be questionable whether the estimate would provide a sufficiently faithful representation of that asset or liability and of any resulting income, expenses or changes in equity. The level of measurement uncertainty may be so high if, for example, the only way of estimating that measure of the asset or liability is by using cash-flow-based measurement techniques and, in addition, one or more of the following circumstances exists:

(a) the range of possible outcomes is exceptionally wide and the probability of each outcome is exceptionally difficult to estimate.

(b) the measure is exceptionally sensitive to small changes in estimates of the probability of different outcomes—for example, if the probability of future cash inflows or outflows occurring is exceptionally low, but the magnitude of those cash inflows or outflows will be exceptionally high if they occur.

(c) measuring the asset or liability requires exceptionally difficult or exceptionally subjective allocations of cash flows that do not relate solely to the asset or liability being measured.

5.21 In some of the cases described in paragraph 5.20, the most useful information may be the measure that relies on the highly uncertain estimate, accompanied by a description of the estimate and an explanation of the uncertainties that affect it. This is especially likely to be the case if that measure is the most relevant measure of the asset or liability. In other cases, if that information would not provide a sufficiently faithful representation of the asset or liability and of any resulting income, expenses or changes in equity, the most useful information may be a different measure (accompanied by any necessary descriptions and explanations) that is slightly less relevant but is subject to lower measurement uncertainty.

5.22 In limited circumstances, all relevant measures of an asset or liability that are available (or can be obtained) may be subject to such high measurement uncertainty that none would provide useful information about the asset or liability (and any resulting income, expenses or changes in equity), even if the measure were accompanied by a description of the estimates made in producing it and an explanation of the uncertainties that affect those estimates. In those limited circumstances, the asset or liability would not be recognised.

5.23 Whether or not an asset or liability is recognised, a faithful representation of the asset or liability may need to include explanatory information about the uncertainties associated with the asset or liability's existence or measurement, or with its outcome—the amount or timing of any inflow or outflow of economic benefits that will ultimately result from it (see paragraphs 6.60–6.62).

Other factors

5.24 Faithful representation of a recognised asset, liability, equity, income or expenses involves not only recognition of that item, but also its measurement as well as presentation and disclosure of information about it (see Chapters 6–7).

5.25 Hence, when assessing whether the recognition of an asset or liability can provide a faithful representation of the asset or liability, it is necessary to consider not merely its description and measurement in the statement of financial position, but also:

(a) the depiction of resulting income, expenses and changes in equity. For example, if an entity acquires an asset in exchange for consideration, not recognising the asset would result in recognising expenses and would reduce the entity's profit and equity. In some cases, for example, if the entity does not consume the asset immediately, that result could provide a misleading representation that the entity's financial position has deteriorated.

(b) whether related assets and liabilities are recognised. If they are not recognised, recognition may create a recognition inconsistency (accounting mismatch). That may not provide an understandable or faithful representation of the overall effect of the transaction or other event giving rise to the asset or liability, even if explanatory information is provided in the notes.

(c) presentation and disclosure of information about the asset or liability, and resulting income, expenses or changes in equity. A complete depiction includes all information necessary for a user of financial statements to understand the economic phenomenon depicted, including all necessary descriptions and explanations. Hence, presentation and disclosure of related information can enable a recognised amount to form part of a faithful representation of an asset, a liability, equity, income or expenses.

Derecognition

5.26 Derecognition is the removal of all or part of a recognised asset or liability from an entity's statement of financial position. Derecognition normally occurs when that item no longer meets the definition of an asset or of a liability:

(a) for an asset, derecognition normally occurs when the entity loses control of all or part of the recognised asset; and

(b) for a liability, derecognition normally occurs when the entity no longer has a present obligation for all or part of the recognised liability.

5.27 Accounting requirements for derecognition aim to faithfully represent both:

(a) any assets and liabilities retained after the transaction or other event that led to the derecognition (including any asset or liability acquired, incurred or created as part of the transaction or other event); and

(b) the change in the entity's assets and liabilities as a result of that transaction or other event.

5.28 The aims described in paragraph 5.27 are normally achieved by:

(a) derecognising any assets or liabilities that have expired or have been consumed, collected, fulfilled or transferred, and recognising any resulting income and expenses. In the rest of this chapter, the term 'transferred component' refers to all those assets and liabilities;

(b) continuing to recognise the assets or liabilities retained, referred to as the 'retained component', if any. That retained component becomes a unit of account separate from the transferred component. Accordingly, no income or expenses are recognised on the retained component as a result of the derecognition of the transferred component, unless the derecognition results in a change in the measurement requirements applicable to the retained component; and

(c) applying one or more of the following procedures, if that is necessary to achieve one or both of the aims described in paragraph 5.27:

(i) presenting any retained component separately in the statement of financial position;

(ii) presenting separately in the statement(s) of financial performance any income and expenses recognised as a result of the derecognition of the transferred component; or

(iii) providing explanatory information.

5.29 In some cases, an entity might appear to transfer an asset or liability, but that asset or liability might nevertheless remain an asset or liability of the entity. For example:

(a) if an entity has apparently transferred an asset but retains exposure to significant positive or negative variations in the amount of economic benefits that may be produced by the asset, this sometimes indicates that the entity might continue to control that asset (see paragraph 4.24); or

(b) if an entity has transferred an asset to another party that holds the asset as an agent for the entity, the transferor still controls the asset (see paragraph 4.25).

5.30 In the cases described in paragraph 5.29, derecognition of that asset or liability is not appropriate because it would not achieve either of the two aims described in paragraph 5.27.

5.31 When an entity no longer has a transferred component, derecognition of the transferred component faithfully represents that fact. However, in some of those cases, derecognition may not faithfully represent how much a transaction or other event changed the entity's assets or liabilities, even when supported by one or more of the procedures described in paragraph 5.28(c). In those cases, derecognition of the transferred component might imply that the entity's financial position has changed more significantly than it has. This might occur, for example:

(a) if an entity has transferred an asset and, at the same time, entered into another transaction that results in a present right or present obligation to reacquire the asset. Such present rights or present obligations may arise from, for example, a forward contract, a written put option, or a purchased call option.

(b) if an entity has retained exposure to significant positive or negative variations in the amount of economic benefits that may be produced by a transferred component that the entity no longer controls.

5.32 If derecognition is not sufficient to achieve both aims described in paragraph 5.27, even when supported by one or more of the procedures described in paragraph 5.28(c), those two aims might sometimes be achieved by continuing to recognise the transferred component. This has the following consequences:

(a) no income or expenses are recognised on either the retained component or the transferred component as a result of the transaction or other event;

(b) the proceeds received (or paid) upon transfer of the asset (or liability) are treated as a loan received (or given); and

(c) separate presentation of the transferred component in the statement of financial position, or provision of explanatory information, is needed to depict the fact that the entity no longer has any rights or obligations arising from the transferred component. Similarly, it may be necessary to provide information about income or expenses arising from the transferred component after the transfer.

5.33 One case in which questions about derecognition arise is when a contract is modified in a way that reduces or eliminates existing rights or obligations. In deciding how to account for contract modifications, it is necessary to consider which unit of account provides users of financial statements with the most useful information about the assets and liabilities retained after the modification, and about how the modification changed the entity's assets and liabilities:

(a) if a contract modification only eliminates existing rights or obligations, the discussion in paragraphs 5.26–5.32 is considered in deciding whether to derecognise those rights or obligations;

(b) if a contract modification only adds new rights or obligations, it is necessary to decide whether to treat the added rights or obligations as a separate asset or liability, or as part of the same unit of account as the existing rights and obligations (see paragraphs 4.48–4.55); and

(c) if a contract modification both eliminates existing rights or obligations and adds new rights or obligations, it is necessary to consider both the separate and the combined effect of those modifications. In some such cases, the contract has been modified to such an extent that, in substance, the modification replaces the old asset or liability with a new asset or liability. In cases of such extensive modification, the entity may need to derecognise the original asset or liability, and recognise the new asset or liability.

from paragraph

CHAPTER 6—MEASUREMENT

Introduction

6.1 Elements recognised in financial statements are quantified in monetary terms. This requires the selection of a measurement basis. A measurement basis is an identified feature—for example, historical cost, fair value or fulfilment value—of an item being measured. Applying a measurement basis to an asset or liability creates a measure for that asset or liability and for related income and expenses.

6.2 Consideration of the qualitative characteristics of useful financial information and of the cost constraint is likely to result in the selection of different measurement bases for different assets, liabilities, income and expenses.

6.3 A Standard may need to describe how to implement the measurement basis selected in that Standard. That description could include:

(a) specifying techniques that may or must be used to estimate a measure applying a particular measurement basis;

(b) specifying a simplified measurement approach that is likely to provide information similar to that provided by a preferred measurement basis; or

(c) explaining how to modify a measurement basis, for example, by excluding from the fulfilment value of a liability the effect of the possibility that the entity may fail to fulfil that liability (own credit risk).

Measurement bases

Historical cost

6.4 Historical cost measures provide monetary information about assets, liabilities and related income and expenses, using information derived, at least in part, from the price of the transaction or other event that gave rise to them. Unlike current value, historical cost does not reflect changes in values, except to the extent that those changes relate to impairment of an asset or a liability becoming onerous (see paragraphs 6.7(c) and 6.8(b)).

6.5 The historical cost of an asset when it is acquired or created is the value of the costs incurred in acquiring or creating the asset, comprising the consideration paid to acquire or create the asset plus transaction costs. The historical cost of a liability when it is incurred or taken on is the value of the consideration received to incur or take on the liability minus transaction costs.

6.6 When an asset is acquired or created, or a liability is incurred or taken on, as a result of an event that is not a transaction on market terms (see paragraph 6.80), it may not be possible to identify a cost, or the cost may not provide relevant information about the asset or liability. In some such cases, a current value of the asset or liability is used as a deemed cost on initial recognition and that deemed cost is then used as a starting point for subsequent measurement at historical cost.

6.7 The historical cost of an asset is updated over time to depict, if applicable:

(a) the consumption of part or all of the economic resource that constitutes the asset (depreciation or amortisation);

(b) payments received that extinguish part or all of the asset;

(c) the effect of events that cause part or all of the historical cost of the asset to be no longer recoverable (impairment); and

(d) accrual of interest to reflect any financing component of the asset.

6.8 The historical cost of a liability is updated over time to depict, if applicable:

(a) fulfilment of part or all of the liability, for example, by making payments that extinguish part or all of the liability or by satisfying an obligation to deliver goods;

(b) the effect of events that increase the value of the obligation to transfer the economic resources needed to fulfil the liability to such an extent that the liability becomes onerous. A liability is onerous if the historical cost is no longer sufficient to depict the obligation to fulfil the liability; and

(c) accrual of interest to reflect any financing component of the liability.

6.9 One way to apply a historical cost measurement basis to financial assets and financial liabilities is to measure them at amortised cost. The amortised cost of a financial asset or financial liability reflects estimates of future cash flows, discounted at a rate determined at initial recognition. For variable rate instruments, the discount rate is updated to reflect changes in the variable rate. The amortised cost of a financial asset or financial liability is updated over time to depict subsequent changes, such as the accrual of interest, the impairment of a financial asset and receipts or payments.

Current value

6.10 Current value measures provide monetary information about assets, liabilities and related income and expenses, using information updated to reflect conditions at the measurement date. Because of the updating, current values of assets and liabilities reflect changes, since the previous measurement date, in estimates of cash flows and other factors reflected in those current values (see paragraphs 6.14–6.15 and 6.20). Unlike historical cost, the current value of an asset or liability is not derived, even in part, from the price of the transaction or other event that gave rise to the asset or liability.

6.11 Current value measurement bases include:

(a) fair value (see paragraphs 6.12–6.16);

(b) value in use for assets and fulfilment value for liabilities (see paragraphs 6.17–6.20); and

(c) current cost (see paragraphs 6.21–6.22).

Fair value

6.12 Fair value is the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date.

6.13 Fair value reflects the perspective of market participants—participants in a market to which the entity has access. The asset or liability is measured using the same assumptions that market participants would use when pricing the asset or liability if those market participants act in their economic best interest.

6.14 In some cases, fair value can be determined directly by observing prices in an active market. In other cases, it is determined indirectly using measurement techniques, for example, cash-flow-based measurement techniques (see paragraphs 6.91–6.95), reflecting all the following factors:

(a) estimates of future cash flows.

(b) possible variations in the estimated amount or timing of future cash flows for the asset or liability being measured, caused by the uncertainty inherent in the cash flows.

(c) the time value of money.

(d) the price for bearing the uncertainty inherent in the cash flows (a risk premium or risk discount). The price for bearing that uncertainty depends on the extent of that uncertainty. It also reflects the fact that investors would generally pay less for an asset (and generally require more for taking on a liability) that has uncertain cash flows than for an asset (or liability) whose cash flows are certain.

(e) other factors, for example, liquidity, if market participants would take those factors into account in the circumstances.

6.15 The factors mentioned in paragraphs 6.14(b) and 6.14(d) include the possibility that a counterparty may fail to fulfil its liability to the entity (credit risk), or that the entity may fail to fulfil its liability (own credit risk).

6.16 Because fair value is not derived, even in part, from the price of the transaction or other event that gave rise to the asset or liability, fair value is not increased by the transaction costs incurred when acquiring the asset and is not decreased by the transaction costs incurred when the liability is incurred or taken on. In addition, fair value does not reflect the transaction costs that would be incurred on the ultimate disposal of the asset or on transferring or settling the liability.

Value in use and fulfilment value

6.17 Value in use is the present value of the cash flows, or other economic benefits, that an entity expects to derive from the use of an asset and from its ultimate disposal. Fulfilment value is the present value of the cash, or other economic resources, that an entity expects to be obliged to transfer as it fulfils a liability.

Those amounts of cash or other economic resources include not only the amounts to be transferred to the liability counterparty, but also the amounts that the entity expects to be obliged to transfer to other parties to enable it to fulfil the liability.

6.18 Because value in use and fulfilment value are based on future cash flows, they do not include transaction costs incurred on acquiring an asset or taking on a liability. However, value in use and fulfilment value include the present value of any transaction costs an entity expects to incur on the ultimate disposal of the asset or on fulfilling the liability.

6.19 Value in use and fulfilment value reflect entity-specific assumptions rather than assumptions by market participants. In practice, there may sometimes be little difference between the assumptions that market participants would use and those that an entity itself uses.

6.20 Value in use and fulfilment value cannot be observed directly and are determined using cash-flow-based measurement techniques (see paragraphs 6.91–6.95). Value in use and fulfilment value reflect the same factors described for fair value in paragraph 6.14, but from an entity-specific perspective rather than from a market-participant perspective.

Current cost

6.21 The current cost of an asset is the cost of an equivalent asset at the measurement date, comprising the consideration that would be paid at the measurement date plus the transaction costs that would be incurred at that date. The current cost of a liability is the consideration that would be received for an equivalent liability at the measurement date minus the transaction costs that would be incurred at that date. Current cost, like historical cost, is an entry value: it reflects prices in the market in which the entity would acquire the asset or would incur the liability. Hence, it is different from fair value, value in use and fulfilment value, which are exit values. However, unlike historical cost, current cost reflects conditions at the measurement date.

6.22 In some cases, current cost cannot be determined directly by observing prices in an active market and must be determined indirectly by other means. For example, if prices are available only for new assets, the current cost of a used asset might need to be estimated by adjusting the current price of a new asset to reflect the current age and condition of the asset held by the entity.

Information provided by particular measurement bases

6.23 When selecting a measurement basis, it is important to consider the nature of the information that the measurement basis will produce in both the statement of financial position and the statement(s) of financial performance. Table 6.1 summarises that information and paragraphs 6.24–6.42 provide additional discussion.

Historical cost

6.24 Information provided by measuring an asset or liability at historical cost may be relevant to users of financial statements, because historical cost uses information derived, at least in part, from the price of the transaction or other event that gave rise to the asset or liability.

6.25 Normally, if an entity acquired an asset in a recent transaction on market terms, the entity expects that the asset will provide sufficient economic benefits that the entity will at least recover the cost of the asset. Similarly, if a liability was incurred or taken on as a result of a recent transaction on market terms, the entity expects that the value of the obligation to transfer economic resources to fulfil the liability will normally be no more than the value of the consideration received minus transaction costs. Hence, measuring an asset or liability at historical cost in such cases provides relevant information about both the asset or liability and the price of the transaction that gave rise to that asset or liability.

6.26 Because historical cost is reduced to reflect consumption of an asset and its impairment, the amount expected to be recovered from an asset measured at historical cost is at least as great as its carrying amount. Similarly, because the historical cost of a liability is increased when it becomes onerous, the value of the obligation to transfer the economic resources needed to fulfil the liability is no more than the carrying amount of the liability.

6.27 If an asset other than a financial asset is measured at historical cost, consumption or sale of the asset, or of part of the asset, gives rise to an expense measured at the historical cost of the asset, or of part of the asset, consumed or sold.

6.28 The expense arising from the sale of an asset is recognised at the same time as the consideration for that sale is recognised as income. The difference between the income and the expense is the margin resulting from the sale. Expenses arising from consumption of an asset can be compared to related income to provide information about margins.

6.29 Similarly, if a liability other than a financial liability was incurred or taken on in exchange for consideration and is measured at historical cost, the fulfilment of all or part of the liability gives rise to income measured at the value of the consideration received for the part fulfilled. The difference between that income and the expenses incurred in fulfilling the liability is the margin resulting from the fulfilment.

6.30 Information about the cost of assets sold or consumed, including goods and services consumed immediately (see paragraph 4.8), and about the consideration received, may have predictive value. That information can be used as an input in predicting future margins from the future sale of goods (including goods not currently held by the entity) and services and hence to assess the entity's prospects for future net cash inflows. To assess an entity's prospects for future cash flows, users of financial statements often focus on the entity's prospects for generating future margins over many periods, not just on its prospects for generating margins from goods already held. Income and expenses measured at historical cost may also have confirmatory value because they may provide feedback to users of financial statements about their previous predictions of cash flows or of margins. Information about the cost of assets sold or consumed may also help in an assessment of how efficiently and effectively the entity's management has discharged its responsibilities to use the entity's economic resources.

6.31 For similar reasons, information about interest earned on assets, and interest incurred on liabilities, measured at amortised cost may have predictive and confirmatory value.

Current value

Fair value

6.32 Information provided by measuring assets and liabilities at fair value may have predictive value because fair value reflects market participants' current expectations about the amount, timing and uncertainty of future cash flows. These expectations are priced in a manner that reflects the current risk preferences of market participants. That information may also have confirmatory value by providing feedback about previous expectations.

6.33 Income and expenses reflecting market participants' current expectations may have some predictive value, because such income and expenses can be used as an input in predicting future income and expenses. Such income and expenses may also help in an assessment of how efficiently and effectively the entity's management has discharged its responsibilities to use the entity's economic resources.

6.34 A change in the fair value of an asset or liability can result from various factors identified in paragraph 6.14. When those factors have different characteristics, identifying separately income and expenses that result from those factors can provide useful information to users of financial statements (see paragraph 7.14(b)).

6.35 If an entity acquired an asset in one market and determines fair value using prices in a different market (the market in which the entity would sell the asset), any difference between the prices in those two markets is recognised as income when that fair value is first determined.

6.36 Sale of an asset or transfer of a liability would normally be for consideration of an amount similar to its fair value, if the transaction were to occur in the market that was the source for the prices used when measuring that fair value. In those cases, if the asset or liability is measured at fair value, the net income or net expenses arising at the time of the sale or transfer would usually be small, unless the effect of transaction costs is significant.

Value in use and fulfilment value

6.37 Value in use provides information about the present value of the estimated cash flows from the use of an asset and from its ultimate disposal. This information may have predictive value because it can be used in assessing the prospects for future net cash inflows.

6.38 Fulfilment value provides information about the present value of the estimated cash flows needed to fulfil a liability. Hence, fulfilment value may have predictive value, particularly if the liability will be fulfilled, rather than transferred or settled by negotiation.

6.39 Updated estimates of value in use or fulfilment value, combined with information about estimates of the amount, timing and uncertainty of future cash flows, may also have confirmatory value because they provide feedback about previous estimates of value in use or fulfilment value.

Current cost

6.40 Information about assets and liabilities measured at current cost may be relevant because current cost reflects the cost at which an equivalent asset could be acquired or created at the measurement date or the consideration that would be received for incurring or taking on an equivalent liability.

6.41 Like historical cost, current cost provides information about the cost of an asset consumed or about income from the fulfilment of liabilities. That information can be used to derive current margins and can be used as an input in predicting future margins. Unlike historical cost, current cost reflects prices prevailing at the time of consumption or fulfilment. When price changes are significant, margins based on current cost may be more useful for predicting future margins than margins based on historical cost.

6.42 To report the current cost of consumption (or current income from fulfilment), it is necessary to split the change in the carrying amount in the reporting period into the current cost of consumption (or current income from fulfilment), and the effect of changes in prices. The effect of a change in prices is sometimes referred to as a 'holding gain' or a 'holding loss'.

Table 6.1—Summary of information provided by particular measurement bases

Assets

Statement of financial position				
	Historical cost	**Fair value (market-participant assumptions)**	**Value in use (entity-specific assumptions)**[(a)]	**Current cost**
Carrying amount	Historical cost (including transaction costs), to the extent unconsumed or uncollected, and recoverable. (Includes interest accrued on any financing component.)	Price that would be received to sell the asset (without deducting transaction costs on disposal).	Present value of future cash flows from the use of the asset and from its ultimate disposal (after deducting present value of transaction costs on disposal).	Current cost (including transaction costs), to the extent unconsumed or uncollected, and recoverable.
Statement(s) of financial performance				
Event	**Historical cost**	**Fair value (market-participant assumptions)**	**Value in use (entity-specific assumptions)**	**Current cost**
Initial recognition[(b)]	—	Difference between consideration paid and fair value of the asset acquired.[(c)] Transaction costs on acquiring the asset.	Difference between consideration paid and value in use of the asset acquired. Transaction costs on acquiring the asset.	—
Sale or consumption of the asset[(d), (e)]	Expenses equal to historical cost of the asset sold or consumed. Income received. (Could be presented gross or net.) Expenses for transaction costs on selling the asset.	Expenses equal to fair value of the asset sold or consumed. Income received. (Could be presented gross or net.) Expenses for transaction costs on selling the asset.	Expenses equal to value in use of the asset sold or consumed. Income received. (Could be presented gross or net.)	Expenses equal to current cost of the asset sold or consumed. Income received. (Could be presented gross or net.) Expenses for transaction costs on selling the asset.
Interest income	Interest income, at historical rates, updated if the asset bears variable interest.	Reflected in income and expenses from changes in fair value. (Could be identified separately.)	Reflected in income and expenses from changes in value in use. (Could be identified separately.)	Interest income, at current rates.
Impairment	Expenses arising because historical cost is no longer recoverable.	Reflected in income and expenses from changes in fair value. (Could be identified separately.)	Reflected in income and expenses from changes in value in use. (Could be identified separately.)	Expenses arising because current cost is no longer recoverable.

Value changes	Not recognised, except to reflect an impairment. For financial assets—income and expenses from changes in estimated cash flows.	Reflected in income and expenses from changes in fair value.	Reflected in income and expenses from changes in value in use.	Income and expenses reflecting the effect of changes in prices (holding gains and holding losses).

(a) This column summarises the information provided if value in use is used as a measurement basis. However, as noted in paragraph 6.75, value in use may not be a practical measurement basis for regular remeasurements.

(b) Income or expenses may arise on the initial recognition of an asset not acquired on market terms.

(c) Income or expenses may arise if the market in which an asset is acquired is different from the market that is the source of the prices used when measuring the fair value of the asset.

(d) Consumption of the asset is typically reported through cost of sales, depreciation or amortisation.

(e) Income received is often equal to the consideration received but will depend on the measurement basis used for any related liability.

Liabilities

Statement of financial position				
	Historical cost	**Fair value (market-participant assumptions)**	**Fulfilment value (entity-specific assumptions)**	**Current cost**
Carrying amount	Consideration received (net of transaction costs) for taking on the unfulfilled part of the liability, increased by excess of estimated cash outflows over consideration received. (Includes interest accrued on any financing component.)	Price that would be paid to transfer the unfulfilled part of the liability (not including transaction costs that would be incurred on transfer).	Present value of future cash flows that will arise in fulfilling the unfulfilled part of the liability (including present value of transaction costs to be incurred in fulfilment or transfer).	Consideration (net of transaction costs) that would be currently received for taking on the unfulfilled part of the liability, increased by excess of estimated cash outflows over that consideration.

Statement(s) of financial performance				
Event	**Historical cost**	**Fair value (market-participant assumptions)**	**Fulfilment value (entity-specific assumptions)**	**Current cost**
Initial recognition[(a)]	—	Difference between consideration received and the fair value of the liability.[(b)] Transaction costs on incurring or taking on the liability.	Difference between consideration received and the fulfilment value of the liability. Transaction costs on incurring or taking on the liability.	—

Statement(s) of financial performance				
Event	**Historical cost**	**Fair value (market-participant assumptions)**	**Fulfilment value (entity-specific assumptions)**	**Current cost**
Fulfilment of the liability	Income equal to historical cost of the liability fulfilled (reflects historical consideration). Expenses for costs incurred in fulfilling the liability. (Could be presented net or gross.)	Income equal to fair value of the liability fulfilled. Expenses for costs incurred in fulfilling the liability. (Could be presented net or gross. If gross, historical consideration could be presented separately.)	Income equal to fulfilment value of the liability fulfilled. Expenses for costs incurred in fulfilling the liability. (Could be presented net or gross. If gross, historical consideration could be presented separately.)	Income equal to current cost of the liability fulfilled (reflects current consideration). Expenses for costs incurred in fulfilling the liability. (Could be presented net or gross. If gross, historical consideration could be presented separately.)
Transfer of the liability	Income equal to historical cost of the liability transferred (reflects historical consideration).	Income equal to fair value of the liability transferred.	Income equal to fulfilment value of the liability transferred.	Income equal to current cost of the liability transferred (reflects current consideration).

	Expenses for costs paid (including transaction costs) to transfer the liability. (Could be presented net or gross.)	Expenses for costs paid (including transaction costs) to transfer the liability. (Could be presented net or gross.)	Expenses for costs paid (including transaction costs) to transfer the liability. (Could be presented net or gross.)	Expenses for costs paid (including transaction costs) to transfer the liability. (Could be presented net or gross.)
Interest expenses	Interest expenses, at historical rates, updated if the liability bears variable interest.	Reflected in income and expenses from changes in fair value. (Could be identified separately.)	Reflected in income and expenses from changes in fulfilment value. (Could be identified separately.)	Interest expenses, at current rates.
Effect of events that cause a liability to become onerous	Expenses equal to the excess of the estimated cash outflows over the historical cost of the liability, or a subsequent change in that excess.	Reflected in income and expenses from changes in fair value. (Could be identified separately.)	Reflected in income and expenses from changes in fulfilment value. (Could be identified separately.)	Expenses equal to the excess of the estimated cash outflows over the current cost of the liability, or a subsequent change in that excess.
Value changes	Not recognised except to the extent that the liability is onerous. For financial liabilities—income and expenses from changes in estimated cash flows.	Reflected in income and expenses from changes in fair value.	Reflected in income and expenses from changes in fulfilment value.	Income and expenses reflecting the effect of changes in prices (holding gains and holding losses).

(a) Income or expenses may arise on the initial recognition of a liability incurred or taken on not on market terms.

(b) Income or expenses may arise if the market in which a liability is incurred or taken on is different from the market that is the source of the prices used when measuring the fair value of the liability.

Factors to consider when selecting a measurement basis

6.43 In selecting a measurement basis for an asset or liability and for the related income and expenses, it is necessary to consider the nature of the information that the measurement basis will produce in both the statement of financial position and the statement(s) of financial performance (see paragraphs 6.23–6.42 and Table 6.1), as well as other factors (see paragraphs 6.44–6.86).

6.44 In most cases, no single factor will determine which measurement basis should be selected. The relative importance of each factor will depend on facts and circumstances.

6.45 The information provided by a measurement basis must be useful to users of financial statements. To achieve this, the information must be relevant and it must faithfully represent what it purports to represent. In addition, the information provided should be, as far as possible, comparable, verifiable, timely and understandable.

6.46 As explained in paragraph 2.21, the most efficient and effective process for applying the fundamental qualitative characteristics would usually be to identify the most relevant information about an economic phenomenon. If that information is not available or cannot be provided in a way that faithfully represents the economic phenomenon, the next most relevant type of information is considered. Paragraphs 6.49–6.76 provide further discussion of the role played by the qualitative characteristics in the selection of a measurement basis.

6.47 The discussion in paragraphs 6.49–6.76 focuses on the factors to be considered in selecting a measurement basis for recognised assets and recognised liabilities. Some of that discussion may also apply in selecting a measurement basis for information provided in the notes, for recognised or unrecognised items.

6.48 Paragraphs 6.77–6.82 discuss additional factors to consider in selecting a measurement basis on initial recognition. If the initial measurement basis is inconsistent with the subsequent measurement basis, income and expenses might be recognised at the time of the first subsequent measurement solely because of the change in measurement basis. Recognising such income and expenses might appear to depict a transaction or other event when, in fact, no such transaction or event has occurred. Hence, the choice of measurement basis for an asset or liability, and for the related income and expenses, is determined by considering both initial measurement and subsequent measurement.

Relevance

6.49 The relevance of information provided by a measurement basis for an asset or liability and for the related income and expenses is affected by:

(a) the characteristics of the asset or liability (see paragraphs 6.50–6.53); and

(b) how that asset or liability contributes to future cash flows (see paragraphs 6.54–6.57).

Characteristics of the asset or liability

6.50 The relevance of information provided by a measurement basis depends partly on the characteristics of the asset or liability, in particular, on the variability of cash flows and on whether the value of the asset or liability is sensitive to market factors or other risks.

6.51 If the value of an asset or liability is sensitive to market factors or other risks, its historical cost might differ significantly from its current value. Consequently, historical cost may not provide relevant information if information about changes in value is important to users of financial statements. For example, amortised cost cannot provide relevant information about a financial asset or financial liability that is a derivative.

6.52 Furthermore, if historical cost is used, changes in value are reported not when that value changes, but when an event such as disposal, impairment or fulfilment occurs. This could be incorrectly interpreted as implying that all the income and expenses recognised at the time of that event arose then, rather than over the periods during which the asset or liability was held. Moreover, because measurement at historical cost does not provide timely information about changes in value, income and expenses reported on that basis may lack predictive value and confirmatory value by not depicting the full effect of the entity's exposure to risk arising from holding the asset or liability during the reporting period.

6.53 Changes in the fair value of an asset or liability reflect changes in expectations of market participants and changes in their risk preferences. Depending on the characteristics of the asset or liability being measured and on the nature of the entity's business activities, information reflecting those changes may not always provide predictive value or confirmatory value to users of financial statements. This may be the case when the entity's business activities do not involve selling the asset or transferring the liability, for example, if the entity holds assets solely for use or solely for collecting contractual cash flows or if the entity is to fulfil liabilities itself.

Contribution to future cash flows

6.54 As noted in paragraph 1.14, some economic resources produce cash flows directly; in other cases, economic resources are used in combination to produce cash flows indirectly. How economic resources are used, and hence how assets and liabilities produce cash flows, depends in part on the nature of the business activities conducted by the entity.

6.55 When a business activity of an entity involves the use of several economic resources that produce cash flows indirectly, by being used in combination to produce and market goods or services to customers, historical cost or current cost is likely to provide relevant information about that activity. For example, property, plant and equipment is typically used in combination with an entity's other economic resources. Similarly, inventory typically cannot be sold to a customer, except by making extensive use of the entity's other economic resources (for example, in production and marketing activities). Paragraphs 6.24–6.31 and 6.40–6.42 explain how measuring such assets at historical cost or current cost can provide relevant information that can be used to derive margins achieved during the period.

6.56 For assets and liabilities that produce cash flows directly, such as assets that can be sold independently and without a significant economic penalty (for example, without significant business disruption), the measurement basis that provides the most relevant information is likely to be a current value that incorporates current estimates of the amount, timing and uncertainty of the future cash flows.

6.57 When a business activity of an entity involves managing financial assets and financial liabilities with the objective of collecting contractual cash flows, amortised cost may provide relevant information that can be used to derive the margin between the interest earned on the assets and the interest incurred on the liabilities. However, in assessing whether amortised cost will provide useful information, it is also necessary to consider the characteristics of the financial asset or financial liability. Amortised cost is unlikely to provide relevant information about cash flows that depend on factors other than principal and interest.

Faithful representation

6.58 When assets and liabilities are related in some way, using different measurement bases for those assets and liabilities can create a measurement inconsistency (accounting mismatch). If financial statements contain measurement inconsistencies, those financial statements may not faithfully represent some aspects of the entity's financial position and financial performance. Consequently, in some circumstances, using the same measurement basis for related assets and liabilities may provide users of financial statements with information that is more useful than the information that would result from using different measurement bases. This may be particularly likely when the cash flows from one asset or liability are directly linked to the cash flows from another asset or liability.

6.59 As noted in paragraphs 2.13 and 2.18, although a perfectly faithful representation is free from error, this does not mean that measures must be perfectly accurate in all respects.

6.60 When a measure cannot be determined directly by observing prices in an active market and must instead be estimated, measurement uncertainty arises. The level of measurement uncertainty associated with a particular measurement basis may affect whether information provided by that measurement basis provides a faithful representation of an entity's financial position and financial performance. A high level of measurement uncertainty does not necessarily prevent the use of a measurement basis that provides relevant information. However, in some cases the level of measurement uncertainty is so high that information provided by a measurement basis might not provide a sufficiently faithful representation (see paragraph 2.22). In such cases, it is appropriate to consider selecting a different measurement basis that would also result in relevant information.

6.61 Measurement uncertainty is different from both outcome uncertainty and existence uncertainty:

(a) outcome uncertainty arises when there is uncertainty about the amount or timing of any inflow or outflow of economic benefits that will result from an asset or liability.

(b) existence uncertainty arises when it is uncertain whether an asset or a liability exists. Paragraphs 5.12–5.14 discuss how existence uncertainty may affect decisions about whether an entity recognises an asset or liability when it is uncertain whether that asset or liability exists.

6.62 The presence of outcome uncertainty or existence uncertainty may sometimes contribute to measurement uncertainty. However, outcome uncertainty or existence uncertainty does not necessarily result in measurement uncertainty. For example, if the fair value of an asset can be determined directly by observing prices in an active market, no measurement uncertainty is associated with the measurement of that fair value, even if it is uncertain how much cash the asset will ultimately produce and hence there is outcome uncertainty.

Enhancing qualitative characteristics and the cost constraint

6.63 The enhancing qualitative characteristics of comparability, understandability and verifiability, and the cost constraint, have implications for the selection of a measurement basis. The following paragraphs discuss those implications. Paragraphs 6.69–6.76 discuss further implications specific to particular measurement bases. The enhancing qualitative characteristic of timeliness has no specific implications for measurement.

6.64 Just as cost constrains other financial reporting decisions, it also constrains the selection of a measurement basis. Hence, in selecting a measurement basis, it is important to consider whether the benefits of the information provided to users of financial statements by that measurement basis are likely to justify the costs of providing and using that information.

6.65 Consistently using the same measurement bases for the same items, either from period to period within a reporting entity or in a single period across entities, can help make financial statements more comparable.

6.66 A change in measurement basis can make financial statements less understandable. However, a change may be justified if other factors outweigh the reduction in understandability, for example, if the change results in more relevant information. If a change is made, users of financial statements may need explanatory information to enable them to understand the effect of that change.

6.67 Understandability depends partly on how many different measurement bases are used and on whether they change over time. In general, if more measurement bases are used in a set of financial statements, the resulting information becomes more complex and, hence, less understandable and the totals or subtotals in the statement of financial position and the statement(s) of financial performance become less informative. However, it could be appropriate to use more measurement bases if that is necessary to provide useful information.

6.68 Verifiability is enhanced by using measurement bases that result in measures that can be independently corroborated either directly, for example, by observing prices, or indirectly, for example, by checking inputs to a model. If a measure cannot be verified, users of financial statements may need explanatory information to enable them to understand how the measure was determined. In some such cases, it may be necessary to specify the use of a different measurement basis.

Historical cost

6.69 In many situations, it is simpler, and hence less costly, to measure historical cost than it is to measure a current value. In addition, measures determined applying a historical cost measurement basis are generally well understood and, in many cases, verifiable.

6.70 However, estimating consumption and identifying and measuring impairment losses or onerous liabilities can be subjective. Hence, the historical cost of an asset or liability can sometimes be as difficult to measure or verify as a current value.

6.71 Using a historical cost measurement basis, identical assets acquired, or liabilities incurred, at different times can be reported in the financial statements at different amounts. This can reduce comparability, both from period to period for a reporting entity and in a single period across entities.

Current value

6.72 Because fair value is determined from the perspective of market participants, not from an entity-specific perspective, and is independent of when the asset was acquired or the liability was incurred, identical assets or liabilities measured at fair value will, in principle, be measured at the same amount by entities that have access to the same markets. This can enhance comparability both from period to period for a reporting entity and in a single period across entities. In contrast, because value in use and fulfilment value reflect an entity-specific perspective, those measures could differ for identical assets or liabilities in different entities. Those differences may reduce comparability, particularly if the assets or liabilities contribute to cash flows in a similar manner.

6.73 If the fair value of an asset or liability can be determined directly by observing prices in an active market, the process of fair value measurement is low-cost, simple and easy to understand; and the fair value can be verified through direct observation.

6.74 Valuation techniques, sometimes including the use of cash-flow-based measurement techniques, may be needed to estimate fair value when it cannot be observed directly in an active market and are generally needed when determining value in use and fulfilment value. Depending on the techniques used:

(a) estimating inputs to the valuation and applying the valuation technique may be costly and complex.

(b) the inputs into the process may be subjective and it may be difficult to verify both the inputs and the validity of the process itself. Consequently, the measures of identical assets or liabilities may differ. That would reduce comparability.

6.75 In many cases, value in use cannot be determined meaningfully for an individual asset used in combination with other assets. Instead, the value in use is determined for a group of assets and the result may then need to be allocated to individual assets. This process can be subjective and arbitrary. In addition, estimates of value in use for an asset may inadvertently reflect the effect of synergies with other assets in the group. Hence, determining the value in use of an asset used in combination with other assets can be a costly process and its complexity and subjectivity reduces verifiability. For these reasons, value in use may not be a practical measurement basis for regular remeasurements of such assets. However, it may be useful for occasional remeasurements of assets, for example, when it is used in an impairment test to determine whether historical cost is fully recoverable.

6.76 Using a current cost measurement basis, identical assets acquired or liabilities incurred at different times are reported in the financial statements at the same amount. This can enhance comparability, both from period to period for a reporting entity and in a single period across entities. However, determining current cost can be complex, subjective and costly. For example, as noted in paragraph 6.22, it may be necessary to estimate the current cost of an asset by adjusting the current price of a new asset to reflect the current age and condition of the asset held by the entity. In addition, because of changes in technology and changes in business practices, many assets would not be replaced with identical assets. Thus, a further subjective adjustment to the current price of a new asset would be required in order to estimate the current cost of an asset equivalent to the existing asset. Also, splitting changes in current cost carrying amounts between the current cost of consumption and the effect of changes in prices (see paragraph 6.42) may be complex and require arbitrary assumptions. Because of these difficulties, current cost measures may lack verifiability and understandability.

Factors specific to initial measurement

6.77 Paragraphs 6.43–6.76 discuss factors to consider when selecting a measurement basis, whether for initial recognition or subsequent measurement. Paragraphs 6.78–6.82 discuss some additional factors to consider at initial recognition.

6.78 At initial recognition, the cost of an asset acquired, or of a liability incurred, as a result of an event that is a transaction on market terms is normally similar to its fair value at that date, unless transaction costs are significant. Nevertheless, even if those two amounts are similar, it is necessary to describe what measurement basis is used at initial recognition. If historical cost will be used subsequently, that measurement basis is also normally appropriate at initial recognition. Similarly, if a current value will be used subsequently, it is also normally appropriate at initial recognition. Using the same measurement basis for initial recognition and subsequent measurement avoids recognising income or expenses at the time of the first subsequent measurement solely because of a change in measurement basis (see paragraph 6.48).

6.79 When an entity acquires an asset, or incurs a liability, in exchange for transferring another asset or liability as a result of a transaction on market terms, the initial measure of the asset acquired, or the liability incurred, determines whether any income or expenses arise from the transaction. When an asset or liability is measured at cost, no income or expenses arise at initial recognition, unless income or expenses arise from the derecognition of the transferred asset or liability, or unless the asset is impaired or the liability is onerous.

6.80 Assets may be acquired, or liabilities may be incurred, as a result of an event that is not a transaction on market terms. For example:

(a) the transaction price may be affected by relationships between the parties, or by financial distress or other duress of one of the parties;

(b) an asset may be granted to the entity free of charge by a government or donated to the entity by another party;

(c) a liability may be imposed by legislation or regulation; or

(d) a liability to pay compensation or a penalty may arise from an act of wrongdoing.

6.81 In such cases, measuring the asset acquired, or the liability incurred, at its historical cost may not provide a faithful representation of the entity's assets and liabilities and of any income or expenses arising from the transaction or other event. Hence, it may be appropriate to measure the asset acquired, or the liability incurred, at deemed cost, as described in paragraph 6.6. Any difference between that deemed cost and any consideration given or received would be recognised as income or expenses at initial recognition.

6.82 When assets are acquired, or liabilities incurred, as a result of an event that is not a transaction on market terms, all relevant aspects of the transaction or other event need to be identified and considered. For example, it may be necessary to recognise other assets, other liabilities, contributions from holders of equity claims or distributions to holders of equity claims to faithfully represent the substance of the effect of the transaction or other event on the entity's financial position (see paragraphs 4.59–4.62) and any related effect on the entity's financial performance.

More than one measurement basis

6.83 Sometimes, consideration of the factors described in paragraphs 6.43–6.76 may lead to the conclusion that more than one measurement basis is needed for an asset or liability and for related income and expenses in order to provide relevant information that faithfully represents both the entity's financial position and its financial performance.

6.84 In most cases, the most understandable way to provide that information is:

(a) to use a single measurement basis both for the asset or liability in the statement of financial position and for related income and expenses in the statement(s) of financial performance; and

(b) to provide in the notes additional information applying a different measurement basis.

6.85 However, in some cases, that information is more relevant, or results in a more faithful representation of both the entity's financial position and its financial performance, through the use of:

(a) a current value measurement basis for the asset or liability in the statement of financial position; and

(b) a different measurement basis for the related income and expenses in the statement of profit or loss[10] (see paragraphs 7.17–7.18).

In selecting those measurement bases, it is necessary to consider the factors discussed in paragraphs 6.43–6.76.

6.86 In such cases, the total income or total expenses arising in the period from the change in the current value of the asset or liability is separated and classified (see paragraphs 7.14–7.19) so that:

(a) the statement of profit or loss includes the income or expenses measured applying the measurement basis selected for that statement; and

(b) other comprehensive income includes all the remaining income or expenses. As a result, the accumulated other comprehensive income related to that asset or liability equals the difference between:

(i) the carrying amount of the asset or liability in the statement of financial position; and

(ii) the carrying amount that would have been determined applying the measurement basis selected for the statement of profit or loss.

Measurement of equity

6.87 The total carrying amount of equity (total equity) is not measured directly. It equals the total of the carrying amounts of all recognised assets less the total of the carrying amounts of all recognised liabilities.

6.88 Because general purpose financial statements are not designed to show an entity's value, the total carrying amount of equity will not generally equal:

(a) the aggregate market value of equity claims on the entity;

(b) the amount that could be raised by selling the entity as a whole on a going concern basis; or

(c) the amount that could be raised by selling all of the entity's assets and settling all of its liabilities.

6.89 Although total equity is not measured directly, it may be appropriate to measure directly the carrying amount of some individual classes of equity (see paragraph 4.65) and some components of equity (see paragraph 4.66). Nevertheless, because total equity is measured as a residual, at least one class of equity cannot be measured directly. Similarly, at least one component of equity cannot be measured directly.

6.90 The total carrying amount of an individual class of equity or component of equity is normally positive, but can be negative in some circumstances. Similarly, total equity is generally positive, but it can be negative, depending on which assets and liabilities are recognised and on how they are measured.

Cash-flow-based measurement techniques

6.91 Sometimes, a measure cannot be observed directly. In some such cases, one way to estimate the measure is by using cash-flow-based measurement techniques. Such techniques are not measurement bases. They are techniques used in applying a measurement basis. Hence, when using such a technique, it is necessary to identify which measurement basis is used and the extent to which the technique reflects the factors applicable to that measurement basis. For example, if the measurement basis is fair value, the applicable factors are those described in paragraph 6.14.

10 The 2018 *NZ Conceptual Framework* does not specify whether the statement(s) of financial performance comprise(s) a single statement or two statements. The *2018 NZ Conceptual Framework* uses the term 'statement of profit or loss' to refer both to a separate statement and to a separate section within a single statement of financial performance.

6.92 Cash-flow-based measurement techniques can be used in applying a modified measurement basis, for example, fulfilment value modified to exclude the effect of the possibility that the entity may fail to fulfil a liability (own credit risk). Modifying measurement bases may sometimes result in information that is more relevant to the users of financial statements or that may be less costly to produce or to understand. However, modified measurement bases may also be more difficult for users of financial statements to understand.

6.93 Outcome uncertainty (see paragraph 6.61(a)) arises from uncertainties about the amount or timing of future cash flows. Those uncertainties are important characteristics of assets and liabilities. When measuring an asset or liability by reference to estimates of uncertain future cash flows, one factor to consider is possible variations in the estimated amount or timing of those cash flows (see paragraph 6.14(b)). Those variations are considered in selecting a single amount from within the range of possible cash flows. The amount selected is itself sometimes the amount of a possible outcome, but this is not always the case. The amount that provides the most relevant information is usually one from within the central part of the range (a central estimate). Different central estimates provide different information. For example:

(a) the expected value (the probability-weighted average, also known as the statistical mean) reflects the entire range of outcomes and gives more weight to the outcomes that are more likely. The expected value is not intended to predict the ultimate inflow or outflow of cash or other economic benefits arising from that asset or liability.

(b) the maximum amount that is more likely than not to occur (similar to the statistical median) indicates that the probability of a subsequent loss is no more than 50% and that the probability of a subsequent gain is no more than 50%.

(c) the most likely outcome (the statistical mode) is the single most likely ultimate inflow or outflow arising from an asset or liability.

6.94 A central estimate depends on estimates of future cash flows and possible variations in their amounts or timing. It does not capture the price for bearing the uncertainty that the ultimate outcome may differ from that central estimate (that is, the factor described in paragraph 6.14(d)).

6.95 No central estimate gives complete information about the range of possible outcomes. Hence users may need information about the range of possible outcomes.

from paragraph

CHAPTER 7—PRESENTATION AND DISCLOSURE

Presentation and disclosure as communication tools

7.1 A reporting entity communicates information about its assets, liabilities, equity, income and expenses by presenting and disclosing information in its financial statements.

7.2 Effective communication of information in financial statements makes that information more relevant and contributes to a faithful representation of an entity's assets, liabilities, equity, income and expenses. It also enhances the understandability and comparability of information in financial statements. Effective communication of information in financial statements requires:

(a) focusing on presentation and disclosure objectives and principles rather than focusing on rules;

(b) classifying information in a manner that groups similar items and separates dissimilar items; and

(c) aggregating information in such a way that it is not obscured either by unnecessary detail or by excessive aggregation.

7.3 Just as cost constrains other financial reporting decisions, it also constrains decisions about presentation and disclosure. Hence, in making decisions about presentation and disclosure, it is important to consider whether the benefits provided to users of financial statements by presenting or disclosing particular information are likely to justify the costs of providing and using that information.

Presentation and disclosure objectives and principles

7.4 To facilitate effective communication of information in financial statements, when developing presentation and disclosure requirements in Standards a balance is needed between:

(a) giving entities the flexibility to provide relevant information that faithfully represents the entity's assets, liabilities, equity, income and expenses; and

(b) requiring information that is comparable, both from period to period for a reporting entity and in a single reporting period across entities.

7.5 Including presentation and disclosure objectives in Standards supports effective communication in financial statements because such objectives help entities to identify useful information and to decide how to communicate that information in the most effective manner.

7.6 Effective communication in financial statements is also supported by considering the following principles:

(a) entity-specific information is more useful than standardised descriptions, sometimes referred to as 'boilerplate'; and

(b) duplication of information in different parts of the financial statements is usually unnecessary and can make financial statements less understandable.

Classification

7.7 Classification is the sorting of assets, liabilities, equity, income or expenses on the basis of shared characteristics for presentation and disclosure purposes. Such characteristics include—but are not limited to—the nature of the item, its role (or function) within the business activities conducted by the entity, and how it is measured.

7.8 Classifying dissimilar assets, liabilities, equity, income or expenses together can obscure relevant information, reduce understandability and comparability and may not provide a faithful representation of what it purports to represent.

Classification of assets and liabilities

7.9 Classification is applied to the unit of account selected for an asset or liability (see paragraphs 4.48–4.55). However, it may sometimes be appropriate to separate an asset or liability into components that have different characteristics and to classify those components separately. That would be appropriate when classifying those components separately would enhance the usefulness of the resulting financial information. For example, it could be appropriate to separate an asset or liability into current and non-current components and to classify those components separately.

Offsetting

7.10 Offsetting occurs when an entity recognises and measures both an asset and liability as separate units of account, but groups them into a single net amount in the statement of financial position. Offsetting classifies dissimilar items together and therefore is generally not appropriate.

7.11 Offsetting assets and liabilities differs from treating a set of rights and obligations as a single unit of account (see paragraphs 4.48–4.55).

Classification of equity

7.12 To provide useful information, it may be necessary to classify equity claims separately if those equity claims have different characteristics (see paragraph 4.65).

7.13 Similarly, to provide useful information, it may be necessary to classify components of equity separately if some of those components are subject to particular legal, regulatory or other requirements. For example, in some jurisdictions, an entity is permitted to make distributions to holders of equity claims only if the entity has sufficient reserves specified as distributable (see paragraph 4.66). Separate presentation or disclosure of those reserves may provide useful information.

Classification of income and expenses

7.14 Classification is applied to:

(a) income and expenses resulting from the unit of account selected for an asset or liability; or

(b) components of such income and expenses if those components have different characteristics and are identified separately. For example, a change in the current value of an asset can include the effects of value changes and the accrual of interest (see Table 6.1). It would be appropriate to classify those components separately if doing so would enhance the usefulness of the resulting financial information.

Profit or loss and other comprehensive income

7.15 Income and expenses are classified and included either:

(a) in the statement of profit or loss;[11] or

(b) outside the statement of profit or loss, in other comprehensive income.

7.16 The statement of profit or loss is the primary source of information about an entity's financial performance for the reporting period. That statement contains a total for profit or loss that provides a highly summarised depiction of the entity's financial performance for the period. Many users of financial statements incorporate that total in their analysis either as a starting point for that analysis or as the main indicator of the entity's financial performance for the period. Nevertheless, understanding an entity's financial performance for the period requires an analysis of all recognised income and expenses—including income and expenses included in other comprehensive income—as well as an analysis of other information included in the financial statements.

7.17 Because the statement of profit or loss is the primary source of information about an entity's financial performance for the period, all income and expenses are, in principle, included in that statement. However, in developing Standards, the Board may decide in exceptional circumstances that income or expenses arising from a change in the current value of an asset or liability are to be included in other comprehensive income when doing so would result in the statement of profit or loss providing more relevant information, or providing a more faithful representation of the entity's financial performance for that period.

7.18 Income and expenses that arise on a historical cost measurement basis (see Table 6.1) are included in the statement of profit or loss. That is also the case when income and expenses of that type are separately

11 The 2018 *NZ Conceptual Framework* does not specify whether the statement(s) of financial performance comprise(s) a single statement or two statements. The 2018 *NZ Conceptual Framework* uses the term 'statement of profit or loss' to refer to a separate statement and to a separate section within a single statement of financial performance. Likewise, it uses the term 'total for profit or loss' to refer both to a total for a separate statement and to a subtotal for a section within a single statement of financial performance.

identified as a component of a change in the current value of an asset or liability. For example, if a financial asset is measured at current value and if interest income is identified separately from other changes in value, that interest income is included in the statement of profit or loss.

7.19 In principle, income and expenses included in other comprehensive income in one period are reclassified from other comprehensive income into the statement of profit or loss in a future period when doing so results in the statement of profit or loss providing more relevant information, or providing a more faithful representation of the entity's financial performance for that future period. However, if, for example, there is no clear basis for identifying the period in which reclassification would have that result, or the amount that should be reclassified, the Board may, in developing Standards, decide that income and expenses included in other comprehensive income are not to be subsequently reclassified.

Aggregation

7.20 Aggregation is the adding together of assets, liabilities, equity, income or expenses that have shared characteristics and are included in the same classification.

7.21 Aggregation makes information more useful by summarising a large volume of detail. However, aggregation conceals some of that detail. Hence, a balance needs to be found so that relevant information is not obscured either by a large amount of insignificant detail or by excessive aggregation.

7.22 Different levels of aggregation may be needed in different parts of the financial statements. For example, typically, the statement of financial position and the statement(s) of financial performance provide summarised information and more detailed information is provided in the notes.

from paragraph

CHAPTER 8—CONCEPTS OF CAPITAL AND CAPITAL MAINTENANCE

The material included in Chapter 8 has been carried forward unchanged from the New Zealand Equivalent to the IASB Conceptual Framework for Financial Reporting 2010*. That material originally appeared in the New Zealand Equivalent to the IASB* Framework for the Preparation and Presentation of Financial Statements, *first issued in 2005.*

Concepts of capital

8.1 A financial concept of capital is adopted by most entities in preparing their financial statements. Under a financial concept of capital, such as invested money or invested purchasing power, capital is synonymous with the net assets or equity of the entity. Under a physical concept of capital, such as operating capability, capital is regarded as the productive capacity of the entity based on, for example, units of output per day.

8.2 The selection of the appropriate concept of capital by an entity should be based on the needs of the users of its financial statements. Thus, a financial concept of capital should be adopted if the users of financial statements are primarily concerned with the maintenance of nominal invested capital or the purchasing power of invested capital. If, however, the main concern of users is with the operating capability of the entity, a physical concept of capital should be used. The concept chosen indicates the goal to be attained in determining profit, even though there may be some measurement difficulties in making the concept operational.

Concepts of capital maintenance and the determination of profit

8.3 The concepts of capital in paragraph 8.1 give rise to the following concepts of capital maintenance:

(a) *Financial capital maintenance*. Under this concept a profit is earned only if the financial (or money) amount of the net assets at the end of the period exceeds the financial (or money) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period. Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power.

(b) *Physical capital maintenance*. Under this concept a profit is earned only if the physical productive capacity (or operating capability) of the entity (or the resources or funds needed to achieve that capacity) at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

8.4 The concept of capital maintenance is concerned with how an entity defines the capital that it seeks to maintain. It provides the linkage between the concepts of capital and the concepts of profit because it provides the point of reference by which profit is measured; it is a prerequisite for distinguishing between an entity's return on capital and its return of capital; only inflows of assets in excess of amounts needed to maintain capital may be regarded as profit and therefore as a return on capital. Hence, profit is the residual amount that remains after expenses (including capital maintenance adjustments, where appropriate) have been deducted from income. If expenses exceed income the residual amount is a loss.

8.5 The physical capital maintenance concept requires the adoption of the current cost basis of measurement. The financial capital maintenance concept, however, does not require the use of a particular basis of measurement. Selection of the basis under this concept is dependent on the type of financial capital that the entity is seeking to maintain.

8.6 The principal difference between the two concepts of capital maintenance is the treatment of the effects of changes in the prices of assets and liabilities of the entity. In general terms, an entity has maintained its capital if it has as much capital at the end of the period as it had at the beginning of the period. Any amount over and above that required to maintain the capital at the beginning of the period is profit.

8.7 Under the concept of financial capital maintenance where capital is defined in terms of nominal monetary units, profit represents the increase in nominal money capital over the period. Thus, increases in the prices of assets held over the period, conventionally referred to as holding gains, are, conceptually, profits. They may not be recognised as such, however, until the assets are disposed of in an exchange transaction. When the concept of financial capital maintenance is defined in terms of constant purchasing power units, profit represents the increase in invested purchasing power over the period. Thus, only that part of the increase in the prices of assets that exceeds the increase in the general level of prices is regarded as profit. The rest of the increase is treated as a capital maintenance adjustment and, hence, as part of equity.

8.8 Under the concept of physical capital maintenance when capital is defined in terms of the physical productive capacity, profit represents the increase in that capital over the period. All price changes affecting the assets and liabilities of the entity are viewed as changes in the measurement of the physical productive capacity of the entity; hence, they are treated as capital maintenance adjustments that are part of equity and not as profit.

8.9 The selection of the measurement bases and concept of capital maintenance will determine the accounting model used in the preparation of the financial statements. Different accounting models exhibit different degrees of relevance and reliability and, as in other areas, management must seek a balance between relevance and reliability. This 2018 *NZ Conceptual Framework* is applicable to a range of accounting models and provides guidance on preparing and presenting the financial statements constructed under the chosen model. At the present time, it is not the intention of the Board to prescribe a particular model other than in exceptional circumstances, such as for those entities reporting in the currency of a hyperinflationary economy. This intention will, however, be reviewed in the light of world developments.

Capital maintenance adjustments

8.10 The revaluation or restatement of assets and liabilities gives rise to increases or decreases in equity. While these increases or decreases meet the definition of income and expenses, they are not included in the income statement under certain concepts of capital maintenance. Instead these items are included in equity as capital maintenance adjustments or revaluation reserves.

Appendix
Defined terms

The following defined terms are extracted or derived from the relevant paragraphs of the 2018 NZ Conceptual Framework for Financial Reporting.

aggregation	The adding together of assets, liabilities, equity, income or expenses that have shared characteristics and are included in the same classification.	CF.7.20
asset	A present economic resource controlled by the entity as a result of past events.	CF.4.3
carrying amount	The amount at which an asset, a liability or equity is recognised in the statement of financial position.	CF.5.1
classification	The sorting of assets, liabilities, equity, income or expenses on the basis of shared characteristics for presentation and disclosure purposes.	CF.7.7
combined financial statements	Financial statements of a reporting entity that comprises two or more entities that are not all linked by a parent-subsidiary relationship.	CF.3.12
consolidated financial statements	Financial statements of a reporting entity that comprises both the parent and its subsidiaries.	CF.3.11
control of an economic resource	The present ability to direct the use of the economic resource and obtain the economic benefits that may flow from it.	CF.4.20
derecognition	The removal of all or part of a recognised asset or liability from an entity's statement of financial position.	CF.5.26
economic resource	A right that has the potential to produce economic benefits.	CF.4.4
enhancing qualitative characteristic	A qualitative characteristic that makes useful information more useful. The enhancing qualitative characteristics are comparability, verifiability, timeliness and understandability.	CF.2.4, CF.2.23
equity	The residual interest in the assets of the entity after deducting all its liabilities.	CF.4.63
equity claim	A claim on the residual interest in the assets of the entity after deducting all its liabilities.	CF.4.64
executory contract	A contract, or a portion of a contract, that is equally unperformed—neither party has fulfilled any of its obligations, or both parties have partially fulfilled their obligations to an equal extent.	CF.4.56
existence uncertainty	Uncertainty about whether an asset or liability exists.	CF.4.13, CF.4.35

expenses	Decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.	CF.4.69
fundamental qualitative characteristic	A qualitative characteristic that financial information must possess to be useful to the primary users of general purpose financial reports. The fundamental qualitative characteristics are relevance and faithful representation.	CF.2.4, CF.2.5
general purpose financial report	A report that provides financial information about the reporting entity's economic resources, claims against the entity and changes in those economic resources and claims that is useful to primary users in making decisions relating to providing resources to the entity.	CF.1.2, CF.1.12
general purpose financial statements	A particular form of general purpose financial reports that provide information about the reporting entity's assets, liabilities, equity, income and expenses.	CF.3.2
income	Increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.	CF.4.68
liability	A present obligation of the entity to transfer an economic resource as a result of past events.	CF.4.26
material information	Information whose omission or misstatement could influence decisions that the primary users of general purpose financial reports make on the basis of those reports, which provide financial information about a specific reporting entity.	CF.2.11
measure	The result of applying a measurement basis to an asset or liability and related income and expenses.	CF.6.1
measurement basis	An identified feature—for example, historical cost, fair value or fulfilment value—of an item being measured.	CF.6.1
measurement uncertainty	Uncertainty that arises when monetary amounts in financial reports cannot be observed directly and must instead be estimated.	CF.2.19
offsetting	Grouping an asset and liability that are recognised and measured as separate units of account into a single net amount in the statement of financial position.	CF.7.10
outcome uncertainty	Uncertainty about the amount or timing of any inflow or outflow of economic benefits that will result from an asset or liability.	CF.6.61
potential to produce economic benefits	Within an economic resource, a feature that already exists and that, in at least one circumstance, would produce for the entity economic benefits beyond those available to all other parties.	CF.4.14
primary users (of general purpose financial reports)	Existing and potential investors, lenders and other creditors.	CF.1.2

prudence	The exercise of caution when making judgements under conditions of uncertainty. The exercise of prudence means that assets and income are not overstated and liabilities and expenses are not understated. Equally, the exercise of prudence does not allow for the understatement of assets or income or the overstatement of liabilities or expenses.	CF.2.16
recognition	The process of capturing for inclusion in the statement of financial position or the statement(s) of financial performance an item that meets the definition of one of the elements of financial statements—an asset, a liability, equity, income or expenses. Recognition involves depicting the item in one of those statements—either alone or in aggregation with other items—in words and by a monetary amount, and including that amount in one or more totals in that statement.	CF.5.1
reporting entity	An entity that is required, or chooses, to prepare general purpose financial statements.	CF.3.10
unconsolidated financial statements	Financial statements of a reporting entity that is the parent alone.	CF.3.11
unit of account	The right or the group of rights, the obligation or the group of obligations, or the group of rights and obligations, to which recognition criteria and measurement concepts are applied.	CF.4.48
useful financial information	Financial information that is useful to primary users of general purpose financial reports in making decisions relating to providing resources to the reporting entity. To be useful, financial information must be relevant and faithfully represent what it purports to represent.	CF.1.2, CF.2.4
users (of general purpose financial reports)	See primary users (of general purpose financial reports).	–

EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho
NZ ACCOUNTING STANDARDS BOARD

Amendments to References to the Conceptual Framework in NZ IFRS

This Standard was issued on 10 May 2018 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 June 2018.

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 reflect the issue of the revised *Conceptual Framework for Financial Reporting* in 2018 (2018 *Conceptual Framework*).

AMENDMENTS TO REFERENCES TO THE CONCEPTUAL FRAMEWORK IN NZ IFRS

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The following is available within New Zealand on the XRB website as additional material

APPROVAL BY THE IASB OF *AMENDMENTS TO REFERENCES TO THE CONCEPTUAL FRAMEWORK IN IFRS STANDARDS* ISSUED IN MARCH 2018

AMENDMENTS TO REFERENCES TO THE CONCEPTUAL FRAMEWORK IN IFRS STANDARDS–Amendments to illustrative examples, implementation guidance and IFRS practice statements

AMENDMENTS TO REFERENCES TO THE CONCEPTUAL FRAMEWORK IN IFRS STANDARDS–Amendments to bases for conclusions on IFRS Standards and IFRS practice statements

Part A

Introduction

This Standard sets out amendments to reflect the issue of the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* in 2018 (2018 *NZ Conceptual Framework*).

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

Part B – *Amendments to References to the Conceptual Framework in NZ IFRS*

Scope

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

Amendments to NZ IFRS 2 *Share-based Payment*

Paragraph 63E is added.

Effective date

...

63E *Amendments to References to the Conceptual Framework in NZ IFRS*, issued in 2018, amended the footnote to the definition of an equity instrument in Appendix A. An entity shall apply that amendment for annual periods beginning on or after 1 January 2020. Earlier application is permitted if at the same time an entity also applies all other amendments made by *Amendments to References to the Conceptual Framework in NZ IFRS*. An entity shall apply the amendment to NZ IFRS 2 retrospectively, subject to the transitional provisions in paragraphs 53–59 of this Standard, in accordance with NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, if an entity determines that retrospective application would be impracticable or would involve undue cost or effort, it shall apply the amendment to NZ IFRS 2 by reference to paragraphs 23–28, 50–53 and 54F of NZ IAS 8.

In Appendix A, the footnote to the definition of an equity instrument is amended. New text is underlined and deleted text is struck through.

5 The New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* issued in 2018 ~~NZ *Framework*~~ defines a liability as a present obligation of the entity ~~arising from~~ to transfer an economic resource as a result of past events~~, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits (ie an outflow of cash or other assets of the entity)~~.

Amendments to NZ IFRS 3 *Business Combinations*

The footnote to '**New Zealand Equivalent to the IASB Framework for the Preparation and Preparation of Financial Statements**' **in paragraph 11 is amended. New text is underlined and deleted text is struck through.**

Recognition conditions

11 To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the New Zealand Equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements*[1] at the acquisition date. For example, costs the acquirer expects but is not obliged to incur in the future to effect its plan to exit an activity of an acquiree or to terminate the employment of or relocate an acquiree's employees are not liabilities at the acquisition date. Therefore, the acquirer does not recognise those costs as part of applying the acquisition method. Instead, the acquirer recognises those costs in its post-combination financial statements in accordance with other NZ IFRSs.

1 ~~IASC's *Framework for the Preparation and Presentation of Financial Statements* was adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.~~ <u>For this Standard, acquirers are required to apply the definitions of an asset and a liability and supporting guidance which were in the New Zealand Equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements* rather than the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* issued in 2018 (2018 *NZ Conceptual Framework*). These definitions of assets and liabilities and supporting guidance were incorporated in Chapter 4 of the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting 2010*.</u>

Amendments to NZ IFRS 4 *Insurance Contracts*

Paragraph NZ 41I.2 is added. Appendix C paragraph 14.1.7 is amended. Appendix D paragraph 17.6.4 is amended.

Effective date and transition

...

NZ 41I.2 *Amendments to References to the Conceptual Framework in NZ IFRS*, issued in 2018, amended paragraph 14.1.7 of Appendix C and paragraph 17.6.4 of Appendix D. An entity shall apply those amendments for annual periods beginning on or after 1 January 2020. Earlier application is permitted if at the same time an entity also applies all other amendments made by *Amendments to References to the Conceptual Framework in NZ IFRS*. An entity shall apply the amendments to NZ IFRS 4 retrospectively in accordance with NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, if an entity determines that retrospective application would be impracticable or would involve undue cost or effort, it shall apply the amendments to NZ IFRS 4 by reference to paragraphs 23–28, 50–53 and 54F of NZ IAS 8.

Appendix C

Life insurance contracts disclosure – explanation of recognised amounts

14.1.7 When a life insurer is presenting the disclosures required by paragraphs 14.1.1(c) and 14.1.1(d) the insurer determines the level and extent of disclosure that is appropriate having regard to its circumstances and the qualitative characteristics of financial statements under the ~~New Zealand~~ 2018 *NZ Conceptual Framework* ~~of understandability, relevance, reliability and comparability~~.

…

Appendix D

Insurance contracts – explanation of recognised amounts

…

17.6.4 When an insurer is presenting the disclosures required by paragraphs 17.6.1(c) and 17.6.1(d) the insurer determines the level and extent of disclosure that is appropriate having regard to its circumstances and the qualitative characteristics of financial statements under the ~~New Zealand~~ 2018 *NZ Conceptual Framework*~~, of understandability, relevance, reliability and comparability~~.

Amendments to NZ IFRS 6 *Exploration for and Evaluation of Mineral Resources*

Paragraph 10 is amended, the footnote to '**NZ Framework**' in paragraph 10 is deleted and paragraph 26A is added. New **text is underlined and deleted text is struck through.**

Elements of cost of exploration and evaluation assets

...

10 Expenditures related to the development of mineral resources shall not be recognised as exploration and evaluation assets. The <u>New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* issued in 2018 (2018 *NZ Conceptual Framework*)</u> ~~NZ *Framework*[1]~~ and NZ IAS 38 *Intangible Assets* provide guidance on the recognition of assets arising from development.

~~1 The reference to the *Framework* is to the New Zealand Equivalent to the IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.~~

Effective date

...

26A *Amendments to References to the Conceptual Framework in NZ IFRS*, issued in 2018, amended paragraph 10. An entity shall apply that amendment for annual periods beginning on or after 1 January 2020. Earlier application is permitted if at the same time an entity also applies all other amendments made by *Amendments to References to the Conceptual Framework in NZ IFRS*. An entity shall apply the amendment to NZ IFRS 6 retrospectively in accordance with NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, if an entity determines that retrospective application would be impracticable or would involve undue cost or effort, it shall apply the amendment to NZ IFRS 6 by reference to paragraphs 23–28, 50–53 and 54F of NZ IAS 8.

Amendment to NZ IFRS 14 *Regulatory Deferral Accounts*

The footnote to the first occurrence of 'reliable' in paragraph **13 is amended. New text is underlined and deleted text is struck through.**

1 ~~In September 2010, the IASB replaced the *Framework for the Preparation and Presentation of Financial Statements* with the *Conceptual Framework for Financial Reporting*.~~ The term "faithful representation"<u>, which is used in the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* issued in 2018 (2018 *NZ Conceptual Framework*)</u> encompasses the main characteristics <u>of the previous term</u> ~~that the previous *Framework* called~~ "reliability". The requirement in paragraph 13 of this Standard is based on the requirements of NZ IAS 8, which retains the term "reliable".

Amendments to NZ IAS 1 *Presentation of Financial Statements*

Paragraphs 7, 15, RDR 15.1, 19–20, 23–24, 28 and 89 are amended and paragraph 139S is added. Two footnotes are deleted—the footnotes to 'paragraph 25' in paragraph **7 and to the second sentence in paragraph 15. New text is underlined and deleted text is struck through.**

Definitions

7 **The following terms are used in this Standard with the meanings specified:**

...

Material **Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.**

Assessing whether an omission or misstatement could influence economic decisions of users, and so be material, requires consideration of the characteristics of those users. ~~The New Zealand Equivalent to the International Accounting Standards Board's *Framework for the Preparation and Presentation of Financial Statements* (NZ *Framework*) states in paragraph 25[2] that 'users~~ <u>Users</u> are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.~~'~~ Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions.

~~2 In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*. Paragraph 25 was superseded by Chapter 3 of the NZ *Framework*.~~

...

Fair presentation and compliance with IFRSs

*15 **Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the <u>New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* issued in 2018 (2018 *NZ Conceptual Framework*)</u>~~NZ *Framework*~~.[3] The application of NZ IFRS, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation.**

RDR 15.1 **Financial statements shall present fairly the financial position, financial performance and cash flows of a Tier 2 entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the ~~NZ *Framework*~~<u>2018 *NZ Conceptual Framework*</u>. The application of the New Zealand equivalents to International Financial Reporting Standards Reduced Disclosure Regime (NZ IFRS RDR), with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation.**

~~3 Paragraphs 15–24 contain references to the objective of financial statements set out in the *Framework [for the Preparation and Presentation of Financial Statements]*. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*, which replaced the objective of financial statements with the objective of general purpose financial reporting: see Chapter 1 of the NZ *Framework*.~~

…

19 **In the extremely rare circumstances in which management concludes that compliance with a requirement in an NZ IFRS would be so misleading that it would conflict with the objective of financial statements set out in the ~~NZ *Framework*~~<u>2018 *NZ Conceptual Framework*</u>, the entity shall depart from that requirement in the manner set out in paragraph 20 if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.**

20 **When an entity departs from a requirement of an NZ IFRS in accordance with paragraph 19, it shall disclose:**

(a) **that management has concluded that the financial statements present fairly the entity's financial position, financial performance and cash flows;**

(b) **that it has complied with applicable NZ IFRSs, except that it has departed from a particular requirement to achieve a fair presentation;**

(c) **the title of the NZ IFRS from which the entity has departed, the nature of the departure, including the treatment that the NZ IFRS would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in the ~~NZ *Framework*~~2018 *NZ Conceptual Framework*, and the treatment adopted; and**

(d) **for each period presented, the financial effect of the departure on each item in the financial statements that would have been reported in complying with the requirement.**

…

23 **In the extremely rare circumstances in which management concludes that compliance with a requirement in an NZ IFRS would be so misleading that it would conflict with the objective of financial statements set out in the ~~NZ *Framework*~~2018 *NZ Conceptual Framework*, but the relevant regulatory framework prohibits departure from the requirement, the entity shall, to the maximum extent possible, reduce the perceived misleading aspects of compliance by disclosing:**

(a) **the title of the NZ IFRS in question, the nature of the requirement, and the reason why management has concluded that complying with that requirement is so misleading in the circumstances that it conflicts with the objective of financial statements set out in the ~~NZ *Framework*~~2018 *NZ Conceptual Framework*; and**

(b) **for each period presented, the adjustments to each item in the financial statements that management has concluded would be necessary to achieve a fair presentation.**

24 For the purpose of paragraphs 19–23, an item of information would conflict with the objective of financial statements when it does not represent faithfully the transactions, other events and conditions that it either purports to represent or could reasonably be expected to represent and, consequently, it would be likely to influence economic decisions made by users of financial statements. When assessing whether complying with a specific requirement in an NZ IFRS would be so misleading that it would conflict with the objective of financial statements set out in the ~~NZ *Framework*~~2018 *NZ Conceptual Framework*, management considers:

(a) why the objective of financial statements is not achieved in the particular circumstances; and

(b) how the entity's circumstances differ from those of other entities that comply with the requirement. If other entities in similar circumstances comply with the requirement, there is a rebuttable presumption that the entity's compliance with the requirement would not be so misleading that it would conflict with the objective of financial statements set out in the ~~NZ *Framework*~~2018 *NZ Conceptual Framework*.

…

Accrual basis of accounting

…

28 When the accrual basis of accounting is used, an entity recognises items as assets, liabilities, equity, income and expenses (the elements of financial statements) when they satisfy the definitions and recognition criteria for those elements in the ~~NZ *Framework*~~2018 *NZ Conceptual Framework*.

…

Profit or loss for the period

…

89 Some NZ IFRSs specify circumstances when an entity recognises particular items outside profit or loss in the current period. NZ IAS 8 specifies two such circumstances: the correction of errors and the effect of changes in accounting policies. Other NZ IFRSs require or permit components of other comprehensive income that meet the ~~NZ *Framework's*~~2018 *NZ Conceptual Framework's* definition of income or expense to be excluded from profit or loss (see paragraph 7).

…

Transition and effective date

...

139S *Amendments to References to the Conceptual Framework in NZ IFRS*, issued in 2018, amended paragraphs 7, 15, RDR 15.1, 19–20, 23–24, 28 and 89. An entity shall apply those amendments for annual periods beginning on or after 1 January 2020. Earlier application is permitted if at the same time an entity also applies all other amendments made by *Amendments to References to the Conceptual Framework in NZ IFRS*. An entity shall apply the amendments to NZ IAS 1 retrospectively in accordance with NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, if an entity determines that retrospective application would be impracticable or would involve undue cost or effort, it shall apply the amendments to NZ IAS 1 by reference to paragraphs 23–28, 50–53 and 54F of NZ IAS 8.

Amendments to NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

Paragraphs 6 and 11(b) are amended. The footnotes to 'paragraph 25' in paragraph **6 and to paragraph 11(b) are deleted and a new footnote to paragraph 11(b) is added. The heading before paragraph 54 is amended and paragraphs 54F–54G are added. New text is underlined and deleted text is struck through.**

Definitions

...

6 Assessing whether an omission or misstatement could influence economic decisions of users, and so be material, requires consideration of the characteristics of those users. ~~The NZ *Framework for the Preparation and Presentation of Financial* Statements states in paragraph 25[2] that "users~~<u>Users</u> are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.~~"~~ Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions.

~~[2] IASC's *Framework for the Preparation and Presentation of Financial Statements* was adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*. Paragraph 25 was superseded by Chapter 3 of the NZ *Framework*.~~

...

Selection and application of accounting policies

...

11 In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:

(a) the requirements in NZ IFRS dealing with similar and related issues; and

(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the ~~NZ *Framework*~~<u>New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* issued in 2018 (2018 *NZ Conceptual Framework*)</u>.~~[3]~~<u>[*]</u>

~~[3] In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.~~

<u>[*] Paragraph 54G explains how this requirement is amended for regulatory account balances.</u>

Effective date <u>and transition</u>

...

54F *Amendments to References to the Conceptual Framework in NZ IFRS*, issued in 2018, amended paragraphs 6 and 11(b). An entity shall apply those amendments for annual periods beginning on or after 1 January 2020. Earlier application is permitted if at the same time an entity also applies all other amendments made by *Amendments to References to the Conceptual Framework in NZ IFRS*. An entity shall apply the amendments to paragraphs 6 and 11(b) retrospectively in accordance with this Standard. However, if an entity determines that retrospective application would be impracticable or would involve undue cost or effort, it shall apply the amendments to paragraphs 6 and 11(b) by reference to paragraphs 23–28 of this Standard. If retrospective application of any amendment in *Amendments to References to the Conceptual Framework in NZ IFRS* would involve undue cost or effort, an entity shall, in applying paragraphs 23–28 of this Standard, read any reference except in the last sentence of paragraph 27 to 'is impracticable' as 'involves undue cost or effort' and any reference to 'practicable' as 'possible without undue cost or effort'.

54G If an entity does not apply NZ IFRS 14 *Regulatory Deferral Accounts*, the entity shall, in applying paragraph 11(b) to regulatory account balances, continue to refer to, and consider the applicability of, the definitions, recognition criteria, and measurement concepts in the New Zealand Equivalent to the *IASB*

Conceptual Framework for Financial Reporting 2010 (NZ Framework) instead of those in the 2018 *NZ Conceptual Framework*. A regulatory account balance is the balance of any expense (or income) account that is not recognised as an asset or a liability in accordance with other applicable NZ IFRSs but is included, or is expected to be included, by the rate regulator in establishing the rate(s) that can be charged to customers. A rate regulator is an authorised body that is empowered by statute or regulation to establish the rate or a range of rates that bind an entity. The rate regulator may be a third-party body or a related party of the entity, including the entity's own governing board, if that body is required by statute or regulation to set rates both in the interest of the customers and to ensure the overall financial viability of the entity.

Amendments to NZ IAS 34 *Interim Financial Reporting*

Paragraphs 31 and 33 are amended and paragraph 58 is added. New text is underlined and deleted text is struck through.

Same accounting policies as annual

...

31 Under the ~~NZ *Framework*~~New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* issued in 2018 (2018 *NZ Conceptual Framework*), recognition is the ~~"~~process of ~~incorporating in the balance sheet or income statement~~ capturing, for inclusion in the statement of financial position or the statement(s) of financial performance, an item that meets the definition of ~~an element~~ one of the elements of the financial statements ~~and satisfies the criteria for recognition"~~. The definitions of assets, liabilities, income, and expenses are fundamental to recognition, at the end of both annual and interim financial reporting periods.

...

33 An essential characteristic of income (revenue) and expenses is that the related inflows and outflows of assets and liabilities have already taken place. If those inflows or outflows have taken place, the related revenue and expense are recognised; otherwise they are not recognised~~. The NZ *Framework* says that "expenses are recognised in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably....~~ [The] ~~NZ *Framework*~~2018 *NZ Conceptual Framework* does not allow the recognition of items in the ~~balance sheet~~statement of financial position which do not meet the definition of assets or liabilities."

...

Effective date

...

58 *Amendments to References to the Conceptual Framework in NZ IFRS*, issued in 2018, amended paragraphs 31 and 33. An entity shall apply those amendments for annual periods beginning on or after 1 January 2020. Earlier application is permitted if at the same time an entity also applies all other amendments made by *Amendments to References to the Conceptual Framework in NZ IFRS*. An entity shall apply the amendments to NZ IAS 34 retrospectively in accordance with NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, if an entity determines that retrospective application would be impracticable or would involve undue cost or effort, it shall apply the amendments to NZ IAS 34 by reference to paragraphs 43–45 of this Standard and paragraphs 23–28, 50–53 and 54F of NZ IAS 8.

Amendment to
NZ IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

A footnote is added to the definition of a liability in paragraph 10.

* The definition of a liability in this Standard was not revised following the revision of the definition of a liability in the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* issued in 2018.

Amendment to
NZ IAS 38 *Intangible Assets*

A footnote is added to the definition of an asset in paragraph 8.

* The definition of an asset in this Standard was not revised following the revision of the definition of an asset in the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* issued in 2018.

Amendment to
NZ IFRIC 12 *Service Concession Arrangements*

The footnote to '**NZ Framework for the Preparation and Presentation of Financial Statements**' in the References section **is amended. New text is underlined and deleted text is struck through.**

* ~~In February 2011 the New Zealand Equivalent to the IASC *Framework for the Preparation and Presentation of Financial Statements* was replaced with the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting*.~~ The conceptual framework that was in effect when the IASB developed IFRIC 12 was the IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the IASB in 2001. IFRIC 12 refers to that framework. The equivalent New Zealand pronouncement was the New Zealand Equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements* which was replaced by the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting 2010.*

Amendment to
NZ IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments*

The footnote to '**NZ Framework for the Preparation and Presentation of Financial Statements**' in the References section **is amended. New text is underlined and deleted text is struck through.**

* ~~In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*. The reference is to the IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the Board in 2001 and in effect when the Interpretation was developed.~~ The conceptual framework that was in effect when the IASB developed IFRIC 19 was the IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the IASB in 2001. IFRIC 19 refers to that framework. The equivalent New Zealand pronouncement was the New Zealand Equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements* which was replaced by the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting 2010.*

Amendment to NZ IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine*

A footnote is added to 'New Zealand Equivalent to the IASB **Conceptual Framework for Financial Reporting (NZ Framework)**' in the References section.

* The conceptual framework that was in effect when the IASB developed IFRIC 20 was the IASB's *Conceptual Framework for Financial Reporting*, issued in 2010. IFRIC 20 refers to that framework. The equivalent New Zealand pronouncement was the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting 2010*.

Amendment to NZ IFRIC 22 *Foreign Currency Transactions and Advance Consideration*

A footnote is added to '**New Zealand Equivalent to the IASB Conceptual Framework for Financial Reporting**' in the **References section.**

* The conceptual framework that was in effect when the IASB developed IFRIC 22 was the IASB's *Conceptual Framework for Financial Reporting*, issued in 2010. IFRIC 20 refers to that framework. The equivalent New Zealand pronouncement was the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting 2010*.

Amendments to NZ SIC-32 *Intangible Assets—Web Site Costs*

Paragraph 5 is amended. A new paragraph is added at the end of the section under the heading 'Effective date'. New **text is underlined and deleted text is struck through.**

Issue

...

5 This Interpretation does not apply to expenditure on purchasing, developing, and operating hardware (eg web servers, staging servers, production servers and Internet connections) of a web site. Such expenditure is accounted for under NZ IAS 16. Additionally, when an entity incurs expenditure on an Internet service provider hosting the entity's web site, the expenditure is recognised as an expense under NZ IAS 1.88 and the ~~NZ *Framework*~~<u>New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* issued in 2018 (2018 *NZ Conceptual Framework*)</u> when the services are received.

...

Effective date

...

Amendments to References to the Conceptual Framework in NZ IFRS, issued in 2018, amended paragraph 5. An entity shall apply that amendment for annual periods beginning on or after 1 January 2020. Earlier application is permitted if at the same time an entity also applies all other amendments made by *Amendments to References to the Conceptual Framework in NZ IFRS*. An entity shall apply the amendment to NZ SIC-32 retrospectively in accordance with NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, if an entity determines that retrospective application would be impracticable or would involve undue cost or effort, it shall apply the amendment to NZ SIC-32 by reference to paragraphs 23–28, 50–53 and 54F of NZ IAS 8.

Amendments to XRB A1 Application of the *Accounting Standards Framework*

The list of authoritative notices in Appendix B is amended. New text is underlined and deleted text is struck through.

APPENDIX B

TIER 1 FOR-PROFIT ACCOUNTING REQUIREMENTS AND TIER 2 FOR-PROFIT ACCOUNTING REQUIREMENTS TO BE APPLIED BY FOR-PROFIT ENTITIES

…

Authoritative Notices

New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting 2010*

New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* issued in 2018 (2018 *NZ Conceptual Framework*)

Part C – Effective Date

This Standard is effective for annual reporting periods beginning on or after 1 January 2020. Earlier application is permitted.

EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	3 May 2017
To:	Graeme Mitchell, External Reporting Board
From:	Kimberley Crook, Chair NZASB
Subject:	**Conceptual Framework**

Introduction[1]

1. In accordance with the protocols established by the XRB Board, the NZASB seeks your approval to issue:

   (a) the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* (the 2018 *NZ Conceptual Framework*); and

   (b) *Amendments to References to the Conceptual Framework in NZ IFRS* (the amending standard).

2. The 2018 *NZ Conceptual Framework* sets out the concepts that underpin general purpose financial reporting. It defines elements, such as assets and liabilities, and contains guidance on matters such as recognition and measurement. The revised conceptual framework will influence the development of IFRS Standards in the future. It also assists preparers of financial statements in applying IFRS Standards and in dealing with topics that have yet to form the subject of a standard or an interpretation. The amending standard updates references to previous conceptual frameworks in certain NZ IFRS.

3. The 2018 *NZ Conceptual Framework* will be issued as an authoritative notice in New Zealand. The Financial Reporting Act 2013 provides for the External Reporting Board (XRB) to "prepare and, if it thinks fit, issue authoritative notices for the purposes of the definition of generally accepted accounting practice" (section 12(c)). The NZASB is not withdrawing the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting 2010* (NZ *Framework*) at this time as there are still a limited number of references to that framework in NZ IFRS.

4. The International Accounting Standards Board (IASB) initially began work on this project with the Financial Accounting Standards Board (FASB). This joint project was organised into phases. The IASB and FASB issued due process documents for two phases – Phase A and Phase D. The IASB subsequently carried on working on this project as an IASB-only project and issued due process documents that related to the whole project. Because the due process for the new framework began back in 2006 we have split the discussion of due process into two sections. The NZASB commented on the due process documents from 2013 onwards.

[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).

Due process: joint project

5. Phase A encompassed the development of two new chapters on the objective of financial reporting and qualitative characteristics. The three milestones for Phase A were as follows.

   (a) In July 2006 the IASB and the FASB jointly issued a Discussion Paper entitled *Preliminary Views on an improved Conceptual Framework for financial reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information.*

   (b) In May 2008 the IASB and FASB jointly issued an ED entitled *An improved Conceptual Framework for Financial Reporting: Chapter 1: The Objective of Financial Reporting and Chapter 2: Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information*.

   (c) In September 2010 the IASB and FASB completed Phase A of the project. The IASB issued the *Conceptual Framework for Financial Reporting.* It included two new chapters: Chapter 1 *The objective of general purpose financial reporting* and Chapter 3 *Qualitative characteristics of useful financial information*. Chapter 2, which would deal with the reporting entity concept, was still under development (see ED/2010/2). Chapter 4 contained the remaining text of the *Framework for the Preparation and Presentation of Financial Statements* (1989). The FASB issued Concepts Statement No. 8, *Conceptual Framework for Financial Reporting* which also included two new chapters.

6. Phase D of the project dealt with the reporting entity. In March 2010 the IASB and FASB jointly issued ED/2010/2 *Conceptual Framework for Financial Reporting – The Reporting Entity*.

7. Work on the conceptual framework project slowed in 2010, due in part to competing priorities. The IASB and FASB discussed Phases B and C (dealing with elements, recognition and measurement) extensively without any consultation document being issued and the project was inactive for some time. During the IASB's 2011 agenda consultation process many respondents asked the IASB to reactivate and finalise the conceptual framework project. In September 2012 the IASB recommenced work on the conceptual framework project as an IASB-only project.

Due process: IASB-only project

8. In July 2013 the IASB issued a Discussion Paper entitled DP/2013/1 *A Review of the Conceptual Framework for Financial Reporting.* This paper covered all aspects of the framework project. This DP was followed by two exposure drafts in May 2015. The remainder of this memo focuses on the matters addressed in those exposure drafts and the due process over the period 2015–2017.

9. In May 2015 the IASB issued:

   (a) ED/2015/3 *Conceptual Framework for Financial Reporting*; and

   (b) ED/2015/4 *Updating References to the Conceptual Framework* (Proposed amendments to IFRS 2, IFRS 3, IFRS 4, IFRS 6, IAS 1, IAS 8, IAS 34, SIC-27 and SIC-32).

10. The NZASB issued these exposure drafts for comment in New Zealand around the same time. Comments were due to the NZASB on 9 October 2015 and to the IASB on 26 October 2015.

11. The NZASB commented on both exposure drafts. The NZASB indicated its support for the conceptual framework project and noted the difficulty of developing a robust conceptual framework within a reasonable period of time, particularly given the gaps in the existing framework, the complexity of the matters involved and the wide diversity of views on how those matters should be addressed. The NZASB's comments acknowledged that the IASB would need to balance requests to further develop concepts with its desire to complete the project in a reasonable timeframe.

12. The key areas of the framework that the NZASB considered required further development were:

    (a) the definition of a liability;

    (b) the chapter on measurement; and

    (c) the meaning of 'financial performance' and the distinction between profit or loss and other comprehensive income (OCI).

13. The NZASB received comments from two respondents. One respondent was generally supportive of the proposals in the exposure drafts but suggested that the IASB elaborate further on the concepts of stewardship and prudence, given the potential for differences in how these terms are understood. The respondent also commented on the difficulty of applying the proposed definition of a liability. These matters were also addressed in the NZASB's comment letter to the IASB. The other respondent did not clearly support or disagree with any of the proposals.

14. The IASB received 233 comment letters and conducted more than 80 outreach meetings on the exposure drafts.

15. The IASB spent two years considering the comments received, deciding how to respond and finalising the text of the chapters. During that time the IASB also sought feedback from groups such as the Accounting Standards Advisory Forum (ASAF) on how it should proceed in relation to certain issues. The Chair of the NZASB and the Chair of the Australian Accounting Standards Board (AASB) provided feedback to the IASB at a number of ASAF meetings in 2016.

16. The IASB's approach to finalising this project was to redeliberate the topics that had proved controversial or where new information had become available and to confirm other proposals without undertaking significant additional analysis. Topics on which the IASB redeliberated included the role of stewardship, the role of prudence, the definition of a liability and the chapter on measurement.

17. In IASB kept constituents informed about its deliberations. In July 2017 the IASB issued *Summary of tentative decisions on the Conceptual Framework for Financial Reporting* which reflected the IASB's tentative decisions as at 21 March 2017. In October 2017 it issued an updated version of that document. In March 2018 it issued a *Feedback Statement*.

18. Following its consideration of comments from constituents, the IASB reviewed the due process steps that it had taken since the publication of the exposure drafts and concluded that the applicable due process steps had been completed. This review of due process occurred at the IASB's meetings in February and March 2017.[2]

19. The IASB issued the *Conceptual Framework for Financial Reporting* (the IASB's Conceptual Framework) and the related amending standard in March 2018. The IASB's Conceptual Framework does not have an effective date. The amending standard is effective for annual periods beginning on or after 1 January 2020 with early application permitted.

20. The NZASB approved the 2018 *NZ Conceptual Framework* and the related amending standard for issue in May 2018, both of which are effective for annual periods beginning on or after 1 January 2020. 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.

21. Although not all of the NZASB's comments are reflected in the IASB's *Conceptual Framework*, the NZASB's comments have helped shape that document and were considered during the IASB's redeliberations. On balance the NZASB is satisfied that the IASB has considered respondents' comments and has been cognisant of the need to proceed with caution in relation to topics where further work is required.

22. In accordance with section 22(2) of the Financial Reporting Act 2013 the NZASB has considered whether the 2018 *NZ Conceptual Framework* and the amending standard are likely to require the disclosure of personal information. In the NZASB's view the 2018 *NZ Conceptual Framework* and the amending standard do 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

23. The 2018 *NZ Conceptual Framework* is issued as an authoritative notice. The amending standard is a standard in its own right. The two pronouncements are identical to the equivalent IASB pronouncements apart from the following minor differences.

    (a) The amending standard has a New Zealand-specific introduction and a scope paragraph limiting its application to Tier 1 and Tier 2 for-profit entities.

    (b) Some of the IASB's amendments have been reworded slightly to reflect the different issue dates and titles of the previous New Zealand conceptual frameworks which were equivalent to those referred to in IFRS.

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[2] The IASB's February 2017 Agenda Paper 10F *Due process summary for the Conceptual Framework for Financial Reporting* is available at: http://www.ifrs.org/Meetings/Pages/IASB-Meeting-February-2017.aspx.
The IASB's March 2017 Agenda Paper 10C *Due process summary for References to the Conceptual Framework* is available at: http://www.ifrs.org/Meetings/Pages/IASB-Meeting-March-2017.aspx.
The IASB Updates for February and March 2017 are available at https://s3.amazonaws.com/ifrswebcontent/2017/IASB/February/IASB-February-Update-2017.pdf and http://www.ifrs.org/-/media/feature/news/updates/iasb/2017/iasb-update-mar-2017.pdf

(c) There are a few additional amendments to New Zealand-specific paragraphs in NZ IFRS.

24. The AASB anticipates issuing the IASB's *Conceptual Framework* later this year for publicly accountable for-profit entities reporting in accordance with the Australian Accounting Standards and other entities voluntarily preparing tier 1 general purpose financial statements. Before doing so the AASB is seeking feedback on options for making the revised *Conceptual Framework* applicable to (i) publicly accountable for-profit entities and other entities voluntarily preparing tier 1 general purpose financial statements and (ii) all other entities required to prepare financial statements in accordance with Australian Accounting Standards.

25. The 2018 *NZ Conceptual Framework* does not establish disclosure requirements and does not discuss the Reduced Disclosure Regime (RDR). The amending standard does not create or substantively amend any disclosure requirements so it does not give rise to any RDR considerations.

26. The issue of the 2018 *NZ Conceptual Framework* and the amending standard is consistent with all three elements of the Financial Reporting Strategy: it adopts the IASB's *Conceptual Framework* and related amending standard, is expected to retain a harmonised position with Australia (with respect to for-profit entities that are required to assert compliance with IFRS) and is consistent with the Accounting Standards Framework.

Recommendation

27. The NZASB recommends that you sign the attached certificates of determination on behalf of the XRB Board.

Attachments

The New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* (2018 *NZ Conceptual Framework*)

Amendments to References to the Conceptual Framework in NZ IFRS

Kimberley Crook
Chair NZASB

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date: 20 April 2018

To: NZASB Members

From: Tracey Crookston and Anthony Heffernan

Subject: ***Amendments to the Scope of FRS-42***

Recommendations

1. We recommend that the Board:

   (a) APPROVES for issue *Amendments to the Scope of FRS-42*; and

   (b) APPROVES the draft signing memorandum from the Chair of the NZASB to the Chair of the XRB Board.

Background

2. In November 2017, the NZASB issued for comment ED NZASB 2017-3 *Amendments to the Scope of FRS-42* (the ED) with a comment date of approximately 100 days ending on 28 February 2018.

3. The ED proposed to amend the scope of FRS-42 *Prospective Financial Statements* by deleting:

   (a) the words "or chooses" from paragraph 3, in order to align the standard's scope with that of XRB A1 *Application of the Accounting Standards Framework*;

   (b) most of the references to "prospective financial information", including the definition of this term in Appendix A;

   (c) public sector examples of prospective financial statements; and

   (d) the explanation of special purpose prospective financial information.

4. Application of the requirements in the standard is encouraged when an entity chooses to present prospective financial statements.

5. Requirements and guidance that are not relevant in the current statutory financial reporting environment, including paragraphs in the Financial Reporting Standards Board's Basis for Conclusions on FRS-42 that are no longer relevant, have been deleted. Some terminology has been amended for consistency with NZ IFRS.

6. The ED was released with a longer than usual comment period due to the comment period extending over the Christmas holiday period.

7. The NZASB received two submissions: One from BDO New Zealand (R1) (see agenda item 9.4.1) and one from the Financial Markets Authority (FMA) (R2) (see agenda item 9.4.2).

8. R1 agreed with the proposed amendments. R2 was comfortable overall with the changes proposed to FRS-42. R2 considered, as particularly helpful, amendments to clarify that FRS-42 applies only to prospective financial statements and the amendments that encourage the application of FRS-42 when an entity chooses to present prospective financial statements.

Reasons for the amending standard

9. The NZASB reviewed the scope of FRS-42 primarily due to recent changes in the regulatory environment (for example, the issuance of the Accounting Standards Framework and changes to securities regulations).

10. The NZASB also became aware of concerns about the scope of FRS-42. Constituents (from the Technical Reference Group (TRG) and other outreach events) had indicated that there is uncertainty about (i) which entities are required to comply with FRS-42; and (ii) the information to which the standard applies.[1]

Due process

11. The NZASB consulted with constituents prior to the issuance of the ED. Those consulted were, the TRG, partners from "Big 4" transaction advisory services teams, a partner in a law firm who advises on capital markets transactions, the FMA and the Ministry for Business Innovation and Employment (MBIE). The wide consultation was appropriate to ensure that the issues were fully understood and the standard amended in a way that would adequately address the issues raised by constituents. The due process followed is outlined below.

12. In August 2016, NZASB staff consulted with a group of selected professionals who had significant experience with applying the requirements of FRS-42, from both a regulatory compliance perspective and from working with preparers who choose to present general purpose prospective financial information. The group comprised partners from the transaction advisory teams of two of the "Big 4" accountancy firms and a partner in a law firm who advises on capital market transactions regarding FRS-42.

13. The consultation was conducted on an informal basis and focused on obtaining feedback on general issues arising from applying the requirements in FRS-42, rather than requesting formal responses to specific questions.

14. In October 2016, the NZASB Chair led an informal working group meeting to further explore FRS-42 practice issues. The FRS-42 practice issues raised by the TRG and those noted from the consultation outlined above were discussed.

15. In June and September 2017, the TRG received an update on the proposed amendments to the scope of FRS-42. At the June meeting, the TRG received a draft NZASB Agenda paper on proposed amendments to FRS-42 which was prepared for the August 2017 NZASB Meeting. In

[1] The TRG, at its meeting in December 2014, raised concerns that preparers were encountering issues when applying the scope of FRS-42 *Prospective Financial Statements.*

September, the TRG received an update following the NZASB's consideration of amendments to FRS-42 at the August meeting.

16. During 2017, prior to issuing the exposure draft, NZASB staff held meetings with staff from the FMA[2] and the Ministry for Business Innovation and Employment (MBIE)[3] to update them on the NZASB's proposed changes to the scope of FRS-42.

17. An effective date of annual periods beginning on or after 1 January 2019, with early application permitted was signalled in the exposure draft. This was proposed because the amendments clarify the scope of FRS-42 rather than imposing additional requirements for preparers.

18. Since exposing the ED, we have amended the wording in the effective date paragraph. We now refer to the standard being effective for "… prospective financial statements published on or after 1 January 2019…" with earlier application permitted. Previously, we referred to "… annual periods beginning on or after…". This change is consistent with the subject matter of the standard (i.e. prospective financial statements) and aligns with the original effective date paragraph of FRS-42.

19. The change in wording of the effective date paragraph does not introduce new requirements – rather it helps clarify the effective date as originally proposed in the ED. Therefore it does not require re-exposure to constituents.

20. 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.

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

Amending standard and signing memo

22. Attached as agenda item 9.2 is a copy of *Amendments to the Scope of FRS-42*. It applies to Tier 1 and Tier 2 for-profit entities only.

23. Attached as agenda item 9.3 is a draft certificate signing memorandum from the Chair of the NZASB to the Chair of the XRB Board.

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2 The FMA noted that it would consider further guidance in the event that it determined there was sufficient risk of harm to investors and financial markets more generally, to encourage the use of FRS-42 when FMC Reporting Entities choose to present general purpose prospective financial statements or PFI (and have no explicit legislative requirement to present prospective financial statements or PFI in accordance with GAAP).

3 MBIE did not anticipate, at this stage, the need to make any legislative changes arising out of the changes to the scope of FRS-42.

Attachments

Agenda item 9.2: *Amendments to the Scope of FRS-42*

Agenda item 9.3: Draft signing memorandum

Agenda item 9.4: Submissions received

9.4.1: BDO New Zealand

9.4.2: Financial Markets Authority

Amendments to the Scope of FRS-42

This Standard was issued on 10 May 2018 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 June 2018.

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 has been issued to amend the scope of FRS-42 *Prospective Financial Statements* and align its requirements with the current statutory financial reporting environment.

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CONTENTS

Part A

Introduction

This Standard amends the scope of FRS-42 *Prospective Financial Statements* so that it applies only to an entity that is required by legislation or regulation to present general purpose prospective financial statements in accordance with generally accepted accounting practice (GAAP). Most references to prospective financial information have also been removed as part of clarifying the scope of FRS-42.

The amendments also align the requirements in FRS-42 with the current statutory financial reporting environment and the mandate of the XRB/NZASB to issue standards for entities with a statutory obligation to prepare, or that opt under an enactment to prepare, general purpose financial reports in accordance with accounting standards issued by the XRB.

Minor editorial corrections have also been made to align the terminology with that used in NZ IFRS.

Part B: Amendments to FRS-42 *Prospective Financial Statements*

Scope

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

The Introduction is amended. New text is underlined and deleted text is struck through.

Main features of the Standard

FRS-42 applies where an entity is required~~, or chooses,~~ by legislation or regulation to present general purpose prospective financial statements ~~information~~ that comply with generally accepted accounting practice. Entities applying the Standard are required to present a complete set of general purpose prospective financial statements for the reporting period for which interim or annual historical general purpose financial statements will subsequently be presented.

…

Paragraphs 1, 3 and 10 are amended, paragraph 3A is added and paragraphs 4, 5, 6, 7, 8 and 9 are deleted. Paragraph 1.1 is provided for context. New text is underlined and deleted text is struck through.

Objective

1 The objective of this Standard is to establish principles and specify minimum disclosures for entities that are required by legislation or regulation to present *general purpose prospective financial statements* (~~hereafter~~ also referred to as "*prospective financial statements*"~~ except where otherwise stated~~) in accordance with generally accepted accounting practice. ~~To provide users with high quality *general purpose prospective financial information*, t~~This Standard requires that an entity presenting general purpose prospective financial ~~information~~ statements presents a complete set of prospective financial statements using the best information that could reasonably be expected to be available and which meet certain qualitative characteristics.

Scope

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

2 [Deleted]

3 An entity shall apply this Standard where it is required by legislation or regulation~~, or chooses,~~ to present general purpose prospective financial statements in accordance with generally accepted accounting practice ~~information~~.

3A An entity is encouraged to apply all the requirements in this Standard when it chooses, to present general purpose prospective financial statements.

4 [Deleted]~~General~~ purpose ~~prospective financial information includes, but is not limited to:~~

~~(a) prospective financial statements required to be published by public sector entities (for example, forecast financial statements of the Crown, forecast financial statements of government departments and Crown entities, and forecast financial statements in annual plans and long-term council community plans of local authorities); and~~

~~(b) prospective financial statements published in a prospectus, investment statement, advertisement for an offer of securities or other similar documents, including prospective financial statements published in order to satisfy the requirements of securities legislation or regulations.~~

5 [Deleted]~~An entity shall apply the principles in this Standard to any prospective financial information published in conjunction with prospective financial statements.~~

6 [Deleted]~~Examples of prospective information to which this Standard does not apply include:~~

(a) ~~special purpose prospective financial information;~~

(b) ~~prospective information expressed solely in general terms; and~~

(c) ~~prospective non-financial information.~~

~~Nonetheless application of the principles and requirements of this Standard to prospective financial information outside the scope of this Standard is encouraged to the extent applicable.~~

7 [Deleted]~~Special purpose prospective financial information is prepared for external users who are able to require, or contract for, the preparation of special reports to meet their specific information needs. It may be prepared in a form agreed to by the parties.~~

8 [Deleted]~~Prospective information which is expressed solely in general terms includes qualitative statements about future prospects. Such statements are commonly found in:~~

(a) ~~management's discussion and analysis within an entity's financial report; and~~

(b) ~~commentary in statements of intent provided by government departments and Crown entities and in long-term council community plans provided by local authorities.~~

~~However, the above information, where presented, should be consistent with any current published prospective financial statements.~~

9 [Deleted]~~Prospective non-financial information includes forward-looking disclosures about an entity's objectives, activities and performance targets. Non-financial information is often provided because financial information alone is unlikely to meet all the needs of users. In the case of public sector entities, legislation may require the publication of prospective non-financial information such as objectives, nature and scope of activities and performance targets in relation to objectives, outputs or outcomes. Where non-financial and financial information is published together they should be consistent.~~

10 An entity whose prospective financial statements comply with FRS-42 shall make an explicit and unreserved statement of such compliance in the notes. Prospective financial statements shall not be described as complying with FRS-42 unless they comply with all the requirements of FRS-42. An entity shall not describe prospective financial statements as complying with IFRSs. An entity wishing to assert that prospective financial statements comply with ~~NZ~~ GAAP may assert compliance with FRS-42 and ~~NZ~~ GAAP as it relates to prospective financial statements.

…

Paragraphs 37, 38 and 40 are amended. New text is underlined and deleted text is struck through.

…

37 The prospective ~~cash flow~~ statement of cash flows shall separately disclose major classes of gross cash receipts and gross cash payments arising from each of the following categories of cash flows, except to the extent that such cash flows are reported on a net basis, as permitted by the relevant standard:

(a) …

38 In the prospective statement of cash flows ~~statement~~:

(a) …

39 …

40 Where an entity presents prospective financial information in addition to the information reported in the prospective financial statements, the relationship of that additional information to the information reported in the prospective financial statements shall be explained. For example, where an entity presents a prospective amount for earnings before interest, tax, depreciation and revaluation movements in addition to a prospective ~~income~~ statement of profit and loss and other comprehensive income that includes the minimum disclosures in paragraphs 31 to 33, the relationship of prospective earnings before interest, tax, depreciation and revaluation movements to the prospective profit or loss shall be explained. The explanation may be by way of reconciliation.

Paragraphs 45 and 46 are amended and paragraphs 42 and 43 are deleted. Paragraphs 41 and 44 are provided for context. New text is underlined and deleted text is struck through.

Accounting policies

41 **Prospective financial statements shall be prepared in accordance with the accounting policies expected to be used in the future for reporting historical general purpose financial statements.**

42 [Deleted]~~Where an entity presents both parent entity and group financial statements for general purpose historical financial reporting, it should consider whether both parent entity and group prospective financial statements should be presented. Factors to consider include the purpose and relevance of the prospective financial statements and whether, in the absence of group prospective financial statements, the statements that are presented meet the qualitative characteristics set out in paragraphs 16 and 17 of this Standard~~.

43 [Deleted]~~Where an entity presents prospective financial statements in respect of the reporting entity for general purpose financial reporting and/or a subset of that reporting entity, such as the borrowing group (as defined in the Securities Regulations 1983):~~

~~(a) the prospective financial statements for the reporting entity for which general purpose financial reports will subsequently be prepared shall be prepared in accordance with the accounting policies expected to be used in the future for reporting historical general purpose financial statements;~~

~~(b) the prospective financial statements for the sub-entity such as the borrowing group shall be prepared in accordance with the accounting policies expected to be used in the future for reporting historical general purpose financial statements except where regulations otherwise require.~~

Periods covered by prospective financial statements

44 **The reporting periods covered by prospective financial statements shall coincide with those for which interim or annual historical general purpose financial statements will subsequently be presented.**

45 When an entity presents historical general purpose financial statements for a period for which prospective financial statements have previously been presented, the comparative requirements in FRS-44 *New Zealand Additional Disclosures* (paragraphs 11.1 and 11.2) are relevant. Where legislation or regulation requires prospective financial statements ~~information~~ to be prepared for a reporting period which differs from the period for which historical general purpose financial statements ~~or information~~ will subsequently be presented, an entity is compelled to comply with such legislation or regulation. However, in such cases the entity may be able to comply with both this Standard and the relevant legislation or regulation by presenting prospective financial information for the balance of the current reporting period and for the subsequent interim or annual reporting period.

46 The number of reporting periods covered by prospective financial statements may vary considerably depending on the relevant legal requirements and the purpose and objective for which the prospective financial statements are prepared. In general, the greater the number of future reporting periods included in prospective financial statements, the more unreliable and uncertain the prospective financial statements become. Entities should exercise caution about publishing prospective financial statements for periods beyond that required by legislation or regulation. ~~Entities publishing prospective financial statements, other than those required to publish prospective financial information by legislation or regulation, should exercise caution in presenting prospective financial statements for more than one reporting period.~~

Paragraphs 63 and 64 are deleted. New text is underlined and deleted text is struck through.

Disclosure of accounting policies

…

63 [Deleted]~~**Where an entity publishes both parent entity and group financial statements for historical financial reporting purposes but does not publish group prospective financial statements, it shall disclose the reasons for not presenting group prospective financial statements.**~~

64 [Deleted]~~**Where an entity publishes prospective financial statements in respect of a subset of a reporting entity in accordance with paragraph 43 it shall disclose:**~~

~~**(a) the reasons for presenting prospective financial statements for the subset; and**~~

~~**(b) whether the entity intends to publish historical financial statements for the subset of the reporting entity for the period or periods covered by the prospective financial statements.**~~

…

Paragraph 71 is amended, paragraph 72G is added and the definition of general purpose prospective financial information in Appendix A is deleted. New text is underlined and deleted text is struck through.

71 Comparison of prospective financial statements with actual financial results is an essential element of accountability. In the case of ~~issuers~~ FMC reporting entities a comparison of actual financial results against the originally published statements is important because it provides users with a comparison of actual performance with the projected performance at the time the entity raised funds. Some entities provide long-term prospective financial statements which are updated annually, prior to the beginning of the year. In such cases a comparison of actual financial results with the most recent prospective financial statements published prior to the beginning of the period is generally relevant. Where information is revised during the course of a year, the reasons for revising the information and an explanation of the differences between the originally published prospective financial statements and the historical financial statements should be given.

Effective date

72 …

72G *Amendments to the Scope of FRS-42*, issued in May 2018, amended paragraphs 1, 3, 10, 37, 38, 40, 45, 46 and 71, added paragraph 3A and deleted paragraphs 4–9, 42, 43, 63 and 64, and the definition of general purpose prospective financial information in Appendix A. An entity shall apply those amendments for prospective financial statements published on or after 1 January 2019. Earlier application is permitted.

Appendix A
Defined terms

This Appendix is an integral part of the Standard.

~~**general purpose prospective financial information**~~	~~One or more future-oriented financial statements prepared for external users who are unable to require, or contract for, the preparation of special reports to meet their specific information needs.~~
general purpose prospective financial statements	Future-oriented financial statements prepared for external users who are unable to require, or contract for, the preparation of special reports to meet their specific information needs.

Paragraph BC1 is amended, headings are inserted above paragraphs BC1 and BC2 and paragraphs BC4–BC8 and the related heading are added. New text is underlined and deleted text is struck through.

NZASB Basis for Conclusions on FRS-42 *Prospective Financial Statements*

This Basis for Conclusions accompanies, but is not part of, FRS-42.

Introduction

BC1 This Basis for Conclusions summarises the New Zealand Accounting Standards Board's (NZASB's) considerations in amending FRS-42 ~~in 2013~~.

2013 Amendments

BC2 The NZASB noted that there was a conflict between the requirements of FRS-42 and the Securities Regulations 2009. In the case of an initial offering of equity securities by a public issuer, the Securities Regulations 2009 (Schedule 1, Clause 11) require the presentation of prospective financial statements for the balance of the current period, and the subsequent interim or annual accounting period. In contrast, FRS-42 required the presentation of prospective financial statements for the reporting period for which annual historical general purpose financial statements will subsequently be presented.

BC3 The NZASB considered that it would be desirable for the reporting period requirements in the Regulations and FRS-42 to be aligned. Having regard to the importance of comparisons between prospective and actual financial statements, the NZASB amended paragraph 44 of FRS-42 to permit the presentation of prospective financial statements for an interim period when an entity is proposing to present historical financial statements for that period. The NZASB considered that this amendment was consistent with the objectives of the Financial Reporting Standards Board (FRSB) when it originally developed FRS-42. The NZASB noted that the FRSB had sought to avoid unnecessary differences between the Securities Regulations and FRS-42, whilst highlighting the importance of being able to compare prospective financial statements with subsequent historical financial statements.

2018 Amendments to the Scope

BC4 The NZASB reviewed and made changes to the scope of FRS-42 primarily due to changes in the regulatory environment (for example, the issuance of the Accounting Standards Framework and changes to regulations).

BC5 The NZASB was also made aware of issues arising with the scope of FRS-42. There was uncertainty about to which entities the Standard applies and the prospective financial information to which it applies.

BC6 The NZASB issued *Amendments to the Scope of FRS-42* in May 2018. This amending standard amended the scope of FRS-42 so that it applies to entities that are required by legislation or regulation to present general purpose prospective financial statements in accordance with generally accepted accounting practice (GAAP). This scope reflects the fact that the NZASB issues financial reporting standards for entities that have a statutory requirement to prepare GAAP-compliant financial statements.

BC7 Most references to prospective financial information were also removed as part of clarifying the scope of FRS-42.

BC8 The NZASB also took the opportunity to align the requirements in FRS-42 with the current statutory financial reporting environment by, for example, deleting public sector examples of prospective financial statements and by deleting requirements about parent entity and group prospective financial statements.

New italicised text is inserted after the first italicised sentence under the main heading. Paragraphs BC9–BC16 and the related heading are deleted. Deleted text is struck through and new text is underlined.

FRSB Basis for Conclusions on FRS-42: *Prospective Financial Statements*

This Basis for Conclusions accompanies, but is not part of, FRS-42.

This Basis for Conclusions has not been revised by the NZASB, except for Paragraphs BC9–BC16 which have been deleted by the NZASB because they are no longer relevant. This also avoids the risk that they might be read out of context.

~~Scope~~

BC9–BC16 [Deleted by NZASB] ~~The Standard is intended to provide guidance for all entities publishing general purpose prospective financial statements. It has been drafted in such a way that it can be applied by profit-oriented and public benefit entities[2] both prior to, and following, the application of New Zealand equivalents to International Financial Reporting Standards (IFRSs). For example, it acknowledges the existence of current legislative requirements governing the preparation of prospective financial statements by public sector entities and uses terminology appropriate for all entities. Following the adoption of IFRSs in New Zealand the FRSB agreed that the format of the Standard should be consistent with recent IFRSs. Paragraphs are numbered sequentially and have equal authority. Paragraphs in bold type state the main principles. Definitions are included in an appendix and are in italics the first time they appear in the Standard.~~

~~BC10 The Standard applies to entities that are required, or choose, to present general purpose prospective financial information. Although the regulations or legislation giving rise to the obligation to present general purpose prospective financial information may refer to one or more prospective financial statements, (for example, a prospective cash flow statement), entities applying the Standard are required to present a complete set of prospective financial statements. They are also required to apply the principles in the Standard to any prospective financial information published in conjunction with general purpose prospective financial statements. These requirements reflect the FRSB's resolution to promote best practice in general purpose prospective financial reporting. The FRSB does not consider that the presentation of a single prospective financial statement in the context of general purpose prospective financial reporting is best practice.~~

~~BC11 The FRSB noted that pro forma information, based on alternative scenarios, is often included in a prospectus and considered the application of the Standard to such pro forma information. For example, where an acquisition is expected to occur during the period, a prospectus may include both prospective financial statements based on the assumption that the acquisition takes place on the expected date and additional information based on the assumption that the projected acquisition will occur on alternative dates. Where such additional prospective pro forma information is published together with the types of general purpose prospective financial statements outlined in paragraph 4, it would fall within the scope of the Standard. However, the Standard does not apply to:~~

~~(a) verbal prospective financial information disclosures or earnings guidance published by a New Zealand Exchange Limited listed issuer;~~

~~(b) individual items of prospective financial information, such as sales forecasts published in an annual report; or~~

~~(c) historical pro forma statements.~~

~~BC13 Prior to issuing ED 103 the FRSB considered whether the scope of the Standard should encompass individual items of prospective financial information published as part of an annual or other report containing general purpose financial information. However, the FRSB noted that it would be difficult to clearly establish the type of information covered by the Standard and considered that such a change would represent a significant change in market practice and would lead to higher compliance costs.~~

~~BC14 Some respondents to ED 103 considered that the requirements of the Standard should also apply to items (a) and (b) in paragraph BC 12. One suggestion was that the Standard should require that such prospective financial information be extracted from prospective financial statements prepared in accordance with the Standard. The FRSB considered extending the scope of the Standard to cover prospective financial information extracted from prospective financial statements. The FRSB did not agree that it was appropriate~~

~~for it to extend the requirements of a financial reporting standard in this way but nevertheless considered that the requirements of the Standard could be applied more widely. For example, the FRSB considered that information extracted from prospective financial statements should be consistent with those prospective financial statements. The FRSB decided that the title of the Standard should be "Prospective Financial Statements" in order to more clearly signal the FRSB's role in developing requirements for financial statements.~~

~~BC15 The Standard does not apply to special purpose prospective financial information (paragraph 6). That is, it does not apply to information prepared for external users who are able to require, or contract, for information to meet their special needs. Examples of prospective financial information prepared for special purposes include a cash flow forecast prepared for lenders and a pro forma consolidated financial report presented to a board to support a proposed acquisition.~~

~~BC16 The Standard does not apply to prospective information expressed solely in general terms (paragraph 6). Prospective information expressed solely in general terms includes:~~

~~(a) management's discussion and analysis within an entity's financial report; and~~

~~(b) commentary in statements of intent provided by government departments and Crown entities and in Long-Term Council Community Plans provided by local authorities.~~

~~Although this discussion or commentary may include qualitative and quantitative statements regarding components of prospective financial statements, it does not fall within the scope of the Standard. Only prospective financial information presented on the face of a prospective financial statement or in the notes accompanying that statement falls within the scope of this Standard.~~

A new footnote is added to BC19. New text is underlined and the footnote is indicated by an asterisk.

Qualitative characteristics

BC19 The FRSB agreed that the Standard should include a discussion of the four qualitative characteristics of understandability, relevance, reliability and comparability described in the New Zealand Equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements* (NZ *Framework*) and in the *Statement of Concepts for General Purpose Financial Reporting* (*Statement of Concepts*) and their applicability to prospective financial statements (paragraphs 16 and 17).* This is based on the premise that the qualities of useful information for establishing financial reporting standards for historical financial statements are also applicable to prospective financial statements.

* The references to the NZ *Framework* and the *Statement of Concepts* in this paragraph are to documents that were relevant at the time FRS-42 was first issued.

A new footnote is added to the heading References. New text is underlined and the footnote is indicated by an asterisk.

References*

* This Appendix refers to documents that were relevant at the time FRS-42 was first issued. Some of these documents have since been superseded.

Part C

Effective Date

This Standard is effective for an entity's prospective financial statements published on or after 1 January 2019. Earlier application is permitted.

EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	3 May 2018
To:	Graeme Mitchell, Chair External Reporting Board
From:	Kimberley Crook, Chair NZASB
Subject:	***Amendments to the Scope of FRS-42***

Introduction

1. In accordance with the protocols established by the XRB Board, the NZASB seeks your approval to issue *Amendments to the Scope of FRS-42* for application by Tier 1 and Tier 2 for-profit entities.

2. FRS-42 *Prospective Financial Statements* establishes principles and specifies minimum disclosures for entities that prepare general purpose prospective financial statements. FRS-42 was developed by the Financial Reporting Standards Board, the predecessor to the NZASB.

3. The NZASB has reviewed the scope of FRS-42 primarily due to recent changes in the regulatory environment (for example, the issuance of the Accounting Standards Framework and changes to securities regulations).

4. The NZASB also became aware of concerns about the scope of FRS-42. Constituents (from the Technical Reference Group (TRG) and other outreach events) had indicated that there is uncertainty about (i) which entities are required to comply with FRS-42; and (ii) the information to which the standard applies.[1]

Due process

5. The NZASB consulted with constituents prior to the issuance of the ED. Those consulted were, the TRG, partners from "Big 4" transaction advisory services teams, a partner in a law firm who advises on capital markets transactions, the FMA and the Ministry for Business Innovation and Employment (MBIE). The wide consultation was appropriate to ensure that the issues were fully understood and the standard amended in a way that would adequately address the issues raised by constituents. The due process followed is outlined below.

6. The NZASB issued for comment ED 2017-3 *Amendments to the scope of FRS-42* in November 2017. The comment period was until 28 February 2018 due to the ED being issued over the Christmas holiday period.

[1] The TRG, at its meeting in December 2014, raised concerns that preparers were encountering issues when applying the scope of FRS-42 *Prospective Financial Statements.*

7. The NZASB received two submissions. One from BDO New Zealand (R1) and one from the Financial Markets Authority (FMA) (R2).

8. R1 agreed with the proposed amendments. R2 was comfortable overall with the changes proposed to FRS-42. R2 considered, as particularly helpful, amendments to clarify that FRS-42 applies only to prospective financial statements and the amendments that encourage the application of FRS-42 when an entity chooses to present prospective financial statements.

9. The NZASB has approved *Amendments to the Scope of FRS-42*. 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.

10. In accordance with section 22(2) of the Financial Reporting Act 2013 the NZASB has considered whether the amending standard is likely to require the disclosure of personal information. In the NZASB's view the amending 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

11. *Amendments to the Scope of FRS-42* is a domestic standard that clarifies the scope of FRS-42.

12. Neither the International Accounting Standards Board nor the Australian Accounting Standards Board have an accounting standard dealing with prospective financial statements for for-profit entities.

Other matters

13. There are no other matters relating to the issue of this amending standard that the NZASB considers to be pertinent or that should be drawn to your attention.

Recommendation

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

Attachment

Amendments to the Scope of FRS-42

Kimberley Crook
Chair NZASB

BDO NEW ZEALAND LIMITED
P O Box 2219
Auckland 1140

12 February 2018

Mr Warren Allen
The Chief Executive
External Reporting Board
PO Box 11250
Manners St Central
Wellington
6142

Dear Sir

Requests to comment on Exposure Draft ED NZASB 2017-3 *2017 Proposed Amendments to FRS-42 Prospective Financial Statements*

Thank you for the opportunity to comment on the above Exposure Draft.

We are making this submission to you to assist the New Zealand Accounting Standards Board (NZASB) with the above Exposure Draft. We are happy for you to publish our comments publically.

In responding we have addressed the specific questions for respondents in Appendix 1.

More information on BDO is provided in Appendix 2 to this letter.

We hope that our responses and comments are helpful. Should you wish to discuss any of the points we have raised or if you have any queries or require further information please contact either of the signatories below.

Yours faithfully,

BDO New Zealand
Michael Rondel
Audit Technical Director

+64 3 353 5527
michael.rondel@bdo.co.nz

Natalie Tyndall
Head of Financial Reporting

+64 9 373 9051
natalie.tyndall@bdo.co.nz

Appendix 1 - Response to questions

Question 1
Do you agree with the proposal to remove the words "or chooses" from paragraph 3 and to delete the last sentence of paragraph 46? If you disagree, please provide reasons.

Yes, we agree with the proposal.

Question 2
Do you agree with the proposal to remove most of the references to "prospective financial information", including the definition of that term in Appendix A? If you disagree, please provide reasons.

Yes, we agree with the proposal.

Question 3
Do you agree with the proposal to delete paragraphs 4–9 from the Scope section of FRS-42? If you disagree, please provide reasons.

Yes, we agree with the proposal.

Question 4
Do you agree with the proposal to add paragraph 3A to encourage entities that choose to prepare prospective financial statements to apply the requirements in FRS-42? If you disagree, please provide reasons.

Yes, we agree with the proposal.

Question 5
Do you agree with the proposal to delete paragraphs 42, 43, 63 and 64? If you disagree, please provide reasons.

Yes, we agree with the proposal.

Question 6
Do you agree with the proposed effective date of annual periods beginning on or after 1 January 2019, with early application permitted, for the proposed amendments to FRS-42? If you disagree, please provide reasons.

Yes, we agree with the proposal.

Question 7
Do you have any other comments on ED NZASB 2017-3?

We have no further comments on ED NZASB 2017-3.

Appendix 2 - Information on BDO

1. BDO New Zealand is a network of eleven independently owned accounting practices, with fifteen offices located throughout New Zealand.

2. BDO firms in New Zealand offer a full range of accountancy services, including business advisory, audit, taxation, risk advisory, internal audit, corporate finance, forensic accounting and business recovery and insolvency.

3. BDO in New Zealand has 89 partners and over 800 staff.

4. BDO firms throughout New Zealand have a significant number of clients in the not-for-profit sector.

5. Five BDO firms in New Zealand (BDO Auckland, BDO Christchurch, BDO Northland, BDO Waikato and BDO Wellington) are registered audit firms and thirteen audit partners are licensed auditors.

6. Internationally, BDO is the fifth largest full-service audit, tax and advisory firm in the world, with over 67,700 people in 1,401 offices across over 158 countries and territories.

From: Jeromy Meerman [mailto:Jeromy.Meerman@fma.govt.nz]
Sent: Wednesday, 21 March 2018 10:44 AM
To: submissions <submissions@xrb.govt.nz>
Cc: Tracey Crookston <Tracey.Crookston@xrb.govt.nz>; Anthony Heffernan <Anthony.Heffernan@xrb.govt.nz>; Sanja Sesto <Sanja.Sesto@fma.govt.nz>
Subject: FMA Comments: Proposed changes to FRS-42

Dear Warren

Thank you for the opportunity to comment on the proposed changes to the scope of FRS-42 *Prospective Financial Statements* set out in ED NZASB 2017-3.

FRS-42 plays a critical role in promoting high quality forecasts for offers of equity and certain managed investment schemes.

Overall we are comfortable with the changes in the standard. In particular we consider the following particularly helpful:

- The amendments to clarify that FRS-42 only applies to prospective financial *statements*
- The encouragement to apply FRS-42 when an entity chooses to present prospective financial statements.

If you have any questions, please contact me directly.

Regards,

Jeromy

Jeromy Meerman **Principal Adviser, Capital Markets Disclosure**
T +64 9 300 0426 **M** +64 21 442 137
E Jeromy.Meerman@fma.govt.nz
Level 5, Ernst & Young Building
2 Takutai Square, Britomart, Auckland, 1010
PO Box 106 672, Auckland 1143, New Zealand
Follow us on Twitter: @fmamedia www.fma.govt.nz
FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TATAI HOKOHOKO - NEW ZEALAND

EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

APPROVAL NZASB 96

Approval to Issue
***Plan Amendment, Curtailment or Settlement* (Amendments to NZ IAS 19)**

In accordance with the protocols established between the New Zealand Accounting Standards Board (NZASB) and the External Reporting Board (XRB Board), the NZASB has:

- approved for issue *Plan Amendment, Curtailment or Settlement* (Amendments to NZ IAS 19); and
- provided a signing memo outlining the due process followed before reaching that decision, and other related information.

I have reviewed the signing memo and am satisfied with the information provided. Accordingly, the NZASB is hereby authorised to issue *Plan Amendment, Curtailment or Settlement* (Amendments to NZ IAS 19) pursuant to section 12(a) of the Financial Reporting Act 2013.

Dated this 26th day of March 2018

G R Mitchell
....
Graeme R Mitchell
Chairman
External Reporting Board