Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Board Meeting Agenda

Virtual Meeting — Thursday, 10 August 2023

Est Time	Item	Topic	Objective		Page
NON-PUBLIC SESSION					
PUBLIC SESSION					
9.40 am	**3**	**PBE Leases**	(GS + CH)		
50 min	3.1	Board memo	Consider	Paper	2
10.30 am 15 min		Morning tea			
NON-PUBLIC SESSION					
PUBLIC SESSION					
11.50 am	**6**	**Tier 2 RDR concessions: Supplier Finance Arrangements**	(JC)		
15 min	6.1	Board memo	Consider	Paper	53
	6.2	Draft amending standard	Approve	Paper	61
NON-PUBLIC SESSION					
12.50 pm 45 min		**Lunch**			
PUBLIC SESSION					
1.35 pm	**8**	**Revenue and Transfer Expenses**	(LVH + CB)		
45 min	8.1	Revenue: project plan	Consider	Paper	68
	8.1A	IPSAS 47: Revenue (Standard)	Note	Supp Paper	–
	8.1B	At a Glance – IPSAS 47 Revenue	Note	Supp Paper	–
	8.2	Transfer Expenses: project plan	Consider	Paper	82
	8.2A	IPSAS 48: Transfer Expenses (Standard)	Note	Supp Paper	–
	8.2B	At a Glance – IPSAS 48 Transfer Expenses	Note	Supp Paper	–
NON-PUBLIC SESSION					
3.10 pm	*Finish*				

Next NZASB meeting: 19 October 2023, in person (Auckland)

Agenda Item 3.1

Memorandum

EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

Date:	28 July 2023
To:	NZASB Members
From:	Gali Slyuzberg and Charis Halliday
Subject:	**PBE IPSAS 43 *Leases*: Effects analysis and next steps**

COVER SHEET

Project priority and complexity

Project priority	**Medium** • The IPSASB issued IPSAS 43 *Leases* in January 2022, which introduces a new lessee accounting model aligned with IFRS 16 *Leases*. PBE Standards are currently not aligned with these updated international requirements. • Leases are prevalent and significant across both the public and NFP sectors.
Complexity of Board decision-making at this meeting	**Medium** The Board is being asked to agree on the next steps of this project, based on the information gathered as part of the more detailed effects analysis recently undertaken by staff. Specifically, staff recommend to: • Commit to the finalisation of PBE IPSAS 43 for application by the public sector, but defer finalisation until certain matters are addressed (as explained in this memo); and • Commit to current lease accounting practice in the NFP sector, with a view to reassessing whether it remains appropriate after PBE IPSAS 43 is adopted in the public sector.

Overview of agenda item

Project status	• Feb 2022: NZASB agreed to propose incorporating IPSAS 43 into PBE Standards. • Aug 2022: XRB issued ED PBE IPSAS 43 *Leases*, which is based on IPSAS 43 and introduces the right-of-use model for lessees (comments closed Nov 2022). • Feb 2023: NZASB considered ED feedback and provided direction on next steps. • May 2023: NZASB considered response to certain points raised in the ED submissions, and provided feedback on staff's plan to carry out a detailed effects analysis. • August 2023: NZASB to agree on next steps based on staff's effects analysis.
Project purpose	• International alignment with IPSASB (as per our PBE Policy Approach) and IASB – allowing PBEs to benefit from the latest international thinking on lease accounting. • Enhance transparency around leases in the financial statements of PBE lessees. • Facilitate easier reporting for 'mixed groups' containing PBEs and for-profit entities.
Board action required at this meeting	CONSIDER the information gathered as part of the more detailed effects analysis undertaken by staff, and AGREE on the next steps of this project. We will ask for Board feedback on the questions raised in this memo. We encourage any editorial comments to be sent directly to staff - gali.slyuzberg@xrb.govt.nz

Purpose and introduction[1]

1. During August–November 2022, the XRB consulted on Exposure Draft (ED) PBE IPSAS 43 *Leases*. The ED proposed a new lessee accounting model for Tier 1 and Tier 2 PBEs. The proposals, which are based on IPSAS 43 and aligned with IFRS 16, would require lessees to recognise most leases on the balance sheet, using the 'right of use' (ROU) model.

2. Key expected benefits of the proposals included alignment with international requirements and best practice, enhanced transparency around leases in the financial statements of PBE lessees, and improved comparability between PBEs that lease assets and those that borrow to buy them.

3. Feedback received on the ED was mixed.

    (a) While there was general support from the public sector for the proposals to incorporate IPSAS 43 into PBE Standards, some public sector respondents expressed concerns and raised questions relating to the scope of the standard and concessionary leases – and while concessionary leases are the focus of 'Phase 2' of the lease accounting project, there is a degree of interconnection between these matters and 'Phase 1' of the leases project.

    (b) Respondents from the not-for-profit (NFP) sector expressed concerns regarding the cost/benefit aspect of the proposals.

4. In light of the mixed feedback received, and the fact that NFP ED respondents continued to express concerns about the ROU model when staff discussed with them potential simplifications to the proposed requirements, the Board agreed in May 2023 that staff should undertake a more detailed effects analysis of the proposals.

5. As part of the effects analysis, staff planned to further understand the costs and benefits of the application of PBE IPSAS 43 in the public and not-for-profit sectors.

6. The purpose of this memo is to update the Board on the results of the more detailed effects analysis, and to seek the Board's agreement on the next steps of this project, in light of the abovementioned results.

Recommendations

7. We recommend that the Board:

    (a) CONSIDERS the information gathered as part of the more detailed effects analysis undertaken by staff; and

    (b) AGREES on the next steps of this project, in light of the above information.

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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).

Structure of this memo

8. This memo includes the following sections.

   (a) Background

   (b) Effects analysis: results and staff recommendations

      (i) Public sector

      (ii) Not-for-profit sector

   (c) Next steps

   (d) Appendices 1A-1C: Background information

   (e) Appendix 2: Discussions with stakeholders in March–May 2023

Background

9. The following background information is included in the appendices of this paper – given that the Board has already seen this information, but may still find it useful to refer back to this information.

   (a) Appendix 1A: Project timeline

   (b) Appendix 1B: Summary of ED PBE IPSAS 43 *Leases* and the Consultation Document

   (c) Appendix 1C: Summary of ED feedback

10. The paragraphs that follow provide a summary of matters discussed at the Board's May 2023 meeting.

Recent modifications to the draft Standard to address feedback from ED respondents

11. In February 2023, the Board expressed the preference to finalise PBE IPSAS 43 in the near future – and not to defer it until it can be finalised together with additional New Zealand requirements for concessionary leases.

12. To advance the finalisation of PBE IPSAS 43, in May 2023 staff discussed with the Board suggested modifications to the draft Standard, in response to certain matters raised by public sector ED respondents.

13. Specifically, the Board agreed with staff's recommendation to:

   (a) Clarify the wording of the requirements for sale and leaseback transactions, in relation to concessionary leaseback arrangements – subject to the changes identified by the Board at the May meeting; and

   (b) Add further disclosure concessions for Tier 2 PBEs, broadly in alignment with the lease-related disclosures in IASB ED *Subsidiaries without Public Accountability: Disclosure*.

14. Staff noted that the remaining matters raised by public sector ED respondents would be addressed after carrying out a more detailed effects analysis in relation to the draft Standard (see paragraph 20 below). These matters include:

(a) The Treasury's comments regarding the scope of PBE IPSAS 43, including whether the scope should exclude certain types of concessionary leases that meet the definition of a lease, and whether requirements should be considered for a broader range of lease-like arrangements; and

(b) Recommendations relating to the 'low value' leased asset threshold, i.e. calls from several respondents to specify a monetary threshold for 'low value', and a recommendation to specify that photocopiers/multi-function devices are generally considered to be 'low value' leased assets.

Discussions during March–May 2023 to address concerns from not-for-profit ED respondents

15. The Board decided in February 2023 that rather than exempting NFP PBEs from the ROU model, staff should explore the development of practical expedients in relation to the ROU model – and that this is to be considered from the NFP perspective in the first instance.

16. During March – May 2023, staff considered possible simplifications and practical expedients in relation to the ROU model, with a view to addressing the concerns from the NFP respondents to the ED. Staff discussed these possible expedients with the Accounting TRG and the NFP stakeholders that responded to the ED.

17. However, during the discussion with the NFP respondents to the ED, the respondents continued to express significant concerns about the ROU model – including concerns about the costs of applying the model and the limited benefits for users – and were of the view that the suggested simplifications would not go far enough to alleviate their concerns.

18. The discussions with the NFP respondents and the TRG during March–May 2023 are summarised in Appendix 2. This summary was presented at the Board's May 2023 meeting.

19. The fact that charities have continued to express concerns regarding the ROU model was one of the key drivers for our recommendation to carry out a more detailed effects analysis of the proposed Standard before proceeding with its finalisation (see paragraph 20 below).

Effects analysis

20. At the May 2023, staff recommended carrying out a more detailed effects analysis in relation to PBE IPSAS 43, for both the public sector and NFP sector – and taking into account feedback received before determining next steps.

21. The Board agreed that staff should undertake the abovementioned effects analysis.

Effects analysis: Results and staff recommendations

22. The paragraphs that follow summarise the results of the effects analysis The information is organised as follows.

(a) Public sector:

(i) Public sector lease accounting requirements in other countries

(ii) Discussions with key stakeholders from the New Zealand public sector

(iii) Staff recommendations – public sector

Public sector

Public sector lease accounting requirements in other countries

Analysis by country

23. While our effects analysis focuses on the effects of PBE IPSAS 43 in New Zealand, we considered it useful to gain an understanding of whether and to what extent other countries have adopted the ROU model, as aligned with IPSAS 43 or IFRS 16, into public sector accounting standards. The countries we have considered for the purpose of this analysis were Australia, the UK, the USA, Canada and South Africa.

24. While this international analysis was not expected to be determinative for our recommendations for the next steps of this project, we considered that it would provide context and learnings that would be useful for the effects analysis. For example:

    (a) If standard setters in the abovementioned countries have required ROU-based lease accounting for the public sector, this could indicate that the benefits of the ROU model were considered to outweigh the costs for the public sector in those countries, at least at the time of introducing the ROU requirements.

    (b) If the ROU model has not been incorporated into public sector accounting standards in a jurisdiction, , this may not necessarily mean that the costs of adopting the ROU model were considered to outweigh the benefits for the public sector in that country (it is possible that the cost and benefits have not yet been considered) – but it would indicate, at the very least, that the need to replace the current lessee accounting model with the ROU model was not seen as urgent for the public sector in the respective country (or at least not as urgent as other public sector accounting projects).

    (c) If some of the jurisdictions mentioned above do not currently require the use of the ROU model in the public sector, this would mean that New Zealand would not be perceived as an 'outlier' internationally in terms of accounting requirements for the public sector, if the Board decides to defer the incorporation of IPSAS 43 into PBE Standards for the public sector.

    (d) If standard setters in the abovementioned countries introduced simplifications in relation to the ROU model requirements for the public and/or NFP sectors, this could be useful for considering simplifications/practical expedients for New Zealand PBEs.

25. The table below provides a summary of our findings in this area.

Table 1: Public sector lease accounting requirements in other countries

Country	Public sector lease accounting requirements			
	Lease accounting aligned with IFRS 16/IPSAS 43?	Are there any simplifications to the ROU requirements?	Comments on the scope of the ROU requirements	Other comments
Australia	**Yes** Public sector entities in Tier 1 and Tier 2 are required to apply AASB 16 *Leases*, which is based on IFRS 16, for periods beginning on/after 1 January 2019.	**Yes:** • **Disclosure concessions:** There are disclosure concessions for public sector entities in Tier 2. • **Fair value measurement not required for concessionary leases** (but is permitted for leases with significantly below market terms). Additional disclosures apply to concessionary leases that are not measured at fair value. Also: Additional simplifications are provided outside of the Standard: • **Incremental borrowing rate:** While AASB 16 does not specifically refer to the use of a published discount rate, we understand that the Australian Treasuries have been publishing discount rates for public sector lessees to use as their incremental borrowing rate (see 'Additional notes on the Australian public sector experience').	• **Concessionary leases in scope – but fair value measurement not required** The scope of AASB 16 does not exclude leases at below-market terms; there are specific references to leases that have significantly below market terms (see the column to the left).	Please see 'Additional notes on the Australian public sector experience' below.
UK	**Yes** IFRS 16 requirements (with modifications) apply to public sector entities for periods beginning on/after 1 April 2022 – except that for local authorities, the requirements apply from 1 April 2024.	**Yes** – the following simplifications are included in the UK Government Financial Reporting Manual (FReM): • **Incremental borrowing rate:** There is an explicit requirement that when the interest rate implicit in the lease cannot be determined, by default entities should use the appropriate discount rate as published by the Treasury as their 'incremental borrowing rate'. • **Short-term leases:** Short-term leases are explicitly exempt from the ROU model, i.e. it is not an accounting policy choice. • **Transitional provisions:** The 'modified retrospective approach' is mandated when applying the IFRS 16 requirements for the first time, i.e. there is no option to apply the 'full retrospective' approach.	• **Concessionary leases in scope – and market value measurement required:** The FReM notes that 'peppercorn' leases, which meet the definition of a lease but for the fact that the consideration is nil or nominal, are in the scope of the ROU requirements. For 'peppercorn' leases, the ROU asset must be measured at its 'current value based on existing use' or at fair value. • **Intra-government agreements where performance may not be legally enforceable are in scope**	ROU assets must be revalued after initial recognition.

<table>
<tr><td rowspan="2">Country</td><td colspan="4">Public sector lease accounting requirements</td></tr>
<tr><td>Lease accounting aligned with IFRS 16/IPSAS 43?</td><td>Are there any simplifications to the ROU requirements?</td><td>Comments on the scope of the ROU requirements</td><td>Other comments</td></tr>
<tr><td>USA</td><td>Yes
GASB Statement 87 Leases is broadly aligned with the IFRS 16 requirements, with some modifications – and has been applicable for periods beginning on/after 15 June 2021.</td><td>Yes
Additional scope exemptions from the ROU requirements are provided, as compared to IFRS 16/IPSAS 43:
Concessionary lease that are not ‘exchange-like’ are out of scope: The definition of a lease in GASB Statement 87 is similar to the definition in IFRS 16/IPSAS 43, except that it explicitly <u>includes only exchange and exchange-like transactions</u>. The BC explains that non-exchange arrangements are accounted for under the GASB standard on non-exchange transactions, although that standard currently does not include specific requirements on the accounting for concessionary leases.
Leases where ownership is transferred to the lessee at the end of the lease term are out of scope: These are accounted for as a financed purchase of the underlying asset.
Simpler requirements for ‘rolling’ leases: GASB Statement 88 specifies that for a <u>‘rolling’ month-on-month or year-on-year lease</u>, if <u>both the lessee and lessor can terminate the lease without permission from the other party</u>, then the <u>maximum lease term is the non-cancellable lease period</u>. In <u>IFRS 16/IPSAS 43</u>, there is a similar requirement but it is <u>subject to the penalty on cancellation being insignificant</u> – and there is an IFRIC agenda decision specifying that the concept of ‘<u>penalty’ is broader than cancellation payments</u>.
Incremental borrowing rate: The GASB requirements for using the ‘incremental borrowing rate’ are simpler – they refer to the <u>interest rate that would be charged to borrow the amount of the lease payments over the lease term</u>.</td><td>There are several additional scope exemptions from the ROU requirements as compared to IFRS 16/IPSAS 43– see the column on the left.
While there is no specific exemption from the ROU model for low-value leased assets – but there is a general note saying that the Statement does not apply to immaterial items.</td><td>N/A</td></tr>
</table>

Country	Public sector accounting requirements			
	Lease accounting aligned with IFRS 16/IPSAS 43?	Are there any simplifications to the ROU requirements?	Comments on the scope of the ROU requirements	Other comments
Canada	**No** – public sector lessees follow the 'risk and rewards'-based model where only 'finance leases' are recognised on the balance sheet. We are not aware of any plans to change this.	N/A	N/A	N/A
South Africa	**No** – public sector lessees follow the 'risk and rewards'-based model where only 'finance leases' are recognised on the balance sheet. We are not aware of any plans to change this.	N/A	N/A	N/A

Additional notes on the Australian public sector experience

26. As noted above, in Australia the public sector has been applying the IFRS 16-aligned AASB 16 *Leases* since 1 January 2019. To understand the effects of applying AASB 16 in the Australian public sector, we have had discussions with staff of the Australian Treasury, Australian Department of Finance and a State Treasury – as the learnings from the Australian experience would be useful to our considerations of the effects of PBE IPSAS 43 in New Zealand.

27. Key points raised by the staff of the abovementioned Australian public sector organisations are summarised below.

    (a) By way of background: The majority of leases in the public sector (in the experience of the staff we spoke to) are property leases, i.e. land and buildings, with State Governments having a significant volume. Rights of renewal are common.

    (b) Introducing AASB 16 had several operational benefits for the public sector – in terms of better management of, and discipline around, leases. For example:

        (i) Implementing AASB 16 helped public sector entities get a better understanding of what lease arrangements they have.

        (ii) The greater transparency around leases helped improved discipline around entering into lease arrangements – for example, it is difficult to justify signing a lease agreement where the rent is much higher than what is paid by other public sector entities.

        (iii) Introducing AASB 16 in the public sector facilitated the standardisation of lease management and reporting on leases, which improves efficiency.

    (c) However, the benefits for users of financial statements (excluding the Finance Department) from the introduction of ROU requirements have been described as being harder to observe. It is not clear whether users are deriving more benefit from the ROU-based lease accounting than they did from the old lease accounting model.

(d) Implementation of AASB 16 was expensive and time consuming at Government/State level, and some negative feedback was received from smaller public sector entities regarding the cost of implementation.

(e) Determining the discount rate for the purpose of the ROU model has not been a major issue for public sector entities, because the Treasury has been providing risk-free discount rates for public sector agencies to use as their discount rates. Risk-free rates are provided for a variety of time periods, and entities select the rate that matches their lease terms.

(f) The fact that AASB 16 does not require concessionary leases to be accounted for at fair value has been helpful and saved a lot of effort. It would have been challenging to determine the fair value of these leases every year, particularly for leases of specialised assets..

(g) Impairment of ROU assets has been challenging. ROU assets need to be tested for impairment when indicators of impairment are present (with limited exceptions). In recent times, economic conditions have been triggering the need to test ROU assets for impairment. Challenges relating to impairment of ROU assets include the following.

    (i) Impairment testing requires determining the recoverable amount of the ROU asset, which is the higher of its fair value and its value in use. Therefore, even when the ROU asset is measured at cost after initial recognition, it is still necessary to determine its fair value for the purpose of impairment testing, when indicators of impairment are present. It can be challenging to determine the relevant market rentals and/or the appropriate discount rate for the purpose of determining the fair value of ROU assets as part of calculating their recoverable amount.

    (ii) Because the impairment test involves considering the ROU asset’s fair value, a decrease in *market rentals* can cause the ROU asset to be impaired, regardless of whether the actual lease payments for the specific lease have changed in line with the market. However, the corresponding lease liability *cannot be decreased until the lessor agrees to decrease the actual lease payments*, which may be 2–3 years in the future, if the agreement is subject to regular rent reviews. Questions have been raised as to whether this asymmetric outcome is sensible.

(h) AASB 16 did not necessitate a change in appropriations, but some Government financial metrics had to be changed.

(i) There have been instances where public sector entities took the opportunity to structure their lease agreements in a way that gives the lessor ‘substantive substitution rights’ over the leased asset – which means that the arrangement does not meet the definition of a lease and is outside the scope of the ROU requirements.

(j) The Australian Bureau of Statistics (ABS) has not adopted the ROU model for the purpose of the Government Financial Statistics (GFS) – which means that the way leases are accounted for in the Government’s financial statements is not aligned with GFS reporting. The difference between the accounting outcomes for leases under AASB 16 versus GFS reporting needs to be explained to the ABS every year, albeit this is now done via a qualitative explanation, as it is not practical for the Government to maintain 'two sets of books' for leases.

Implications for lease accounting requirements for the New Zealand public sector:

28. The analysis above has the following possible implication for the development of lease accounting requirements for the New Zealand public sector:

    (a) Not all the countries that we considered have introduced ROU-based requirements for public sector entities – specifically, Canada and South Africa have not. Therefore, if New Zealand were to defer the finalisation of PBE IPSAS 43 for the public sector, this would *not* cause our public sector to be an international 'outlier' in this regard.

    (b) Australia, the UK and the USA have introduced ROU requirements aligned with IFRS 16/IPSAS 43 for the public sector – but the UK and USA have introduced simplifications to the discount rate requirements in the respective standards, as compared to IFRS 16/IPSAS 43. Furthermore, in Australia, practical expedients are provided outside of the Standard, in the form of published Treasury rates – and we understand that because of this, determining the appropriate discount rate has not been a major challenge for Australian public sector entities. Similar practical expedients could be useful in the New Zealand public sector.

    (c) Furthermore, the UK and USA have included other simplifications to the ROU requirements for the public sector. Similar expedients could be useful for the New Zealand public sector.

    (d) The USA has excluded concessionary leases that are not 'exchange-like' from the scope of its ROU-based lease requirements for the public sector. On the other hand, the UK specifically included intra-government arrangements where performance is not legally enforceable within the scope of the ROU requirements. These scope-related modifications could be useful in considering how to respond to the comment in the New Zealand Treasury's ED submission regarding the scope of draft PBE IPSAS 43.

    (e) Lease accounting requirements are still relatively new in the UK and USA public sectors – there could be merit in waiting to understand the implementation experience from those countries before finalising PBE IPSAS 43 for the public sector.

    (f) Our discussions with Australian public sector representatives have indicated that the impairment of ROU assets can be a challenging area. It may be worth considering possible modifications to draft PBE IPSAS 43 to assist New Zealand public sector entities in the application of impairment requirements to ROU assets – and to closely monitor the IASB's PIR of IFRS 16 to check if similar issues arise in the public sector and whether and how the IASB may resolve these issues.

Discussions with key stakeholders from the New Zealand public sector

The lease landscape in the public sector – central government

29. As part of the more detailed effects analysis of draft PBE IPSAS 43, we have spoken to staff of the New Zealand Treasury – to obtain an understanding of leases within the Government group reporting entity, and to further understand the impact of applying PBE IPSAS 43 for the Government and central government entities. This is additive to earlier research we looked at on the effects for Councils, as discussed in previous board meetings.

30. The following table shows information on leases within the Government group reporting entity for the year ended 30 June 2022 – and staff's summary of the implications for the application of PBE IPSAS 43 in the public sector.

Table 2 The lease landscape in the public sector

Information	Implications – PBE IPSAS 43
Finance leases: 15 entities within the Government group reporting entity recorded finance lease liabilities, which in total amounted to $1.2 billion. In total, $1.5 billion of leased assets (leased via finance leases) were recognised within property, plant and equipment for the Government group reporting entity. The majority of those amounts relate to leases of aircrafts within the State-Owned Enterprise (SOE) sector. ***Operating lease commitments:*** 110 entities within the Government group reporting entity recorded operating lease commitments, which in total amounted to $10 billion (undiscounted) for the group. We understand that this figure excludes 'notional rent' on school properties. Of the total operating lease commitments amount, $5.6 billion (undiscounted) related to non-cancellable accommodation leases, and $1.3 billion related to universities and wānanga.	Under PBE IPSAS 43 as currently drafted, the operating lease commitment amounts would need to be discounted and recognised on the balance sheet (with the exception of short-term leases and leases of 'low value' items) – together with the finance lease liabilities and related assets that are already recognised. As can be seen from the number of entities that have operating leases, this accounting change would affect a large number of individual public sector entities (who have to prepare financial statements) – and as can be seen from the amount of operating lease commitments, the effect on the Government's and related individual entities' balance sheets could be significant.
Lease expense: The 'gross' total of lease expenses recognised by entities within the Government group reporting entity – before intra-group eliminations – amounted to $2.6 billion. Of that amount, about $1.1 related to the 'notional lease expense' recognised by schools with respect to the rent-free use of school land and buildings.	Schools and the Ministry of Education (MOE) would need to determine whether the arrangements that allow schools to use property rent-free are in the scope of PBE IPSAS 43. MOE raised a similar question in its submission on the ED. ED PBE IPSAS 43 states that arrangements to use an asset for a specified period of time for no consideration do not meet the definition of a lease, and are therefore outside the scope of PBE IPSAS 43. However, given the Treasury's recommendations (in its ED submission and in discussions with staff) to consider further and clarify the scope of PBE IPSAS 43, there could be merit in considering clarifications regarding what types of arrangement are in/out of scope – either in the Standard or via guidance.

31. In addition, we understand that the application of PBE IPSAS 43 could result in some practical challenges for central government in relation to legislative restrictions on borrowings, determining whether changes to appropriations are needed, determining impact on fiscal indicators, etc.

Circling back on next steps for the public sector – Treasury, OAG and Audit New Zealand

32. In commenting on ED PBE IPSAS 43 in 2022, the Treasury and OAG/Audit New Zealand were broadly supportive of introducing the proposed requirements in the ED for the public sector, except that the Treasury recommended considering further the <u>scope</u> of the proposed Standard with respect to concessionary leases and other rights-to-use arrangements, and both submissions recommended certain specific modifications (e.g. more Tier 2 concessions).

33. As part of the more detailed effects analysis of draft PBE IPSAS 43, we have circled back to the Treasury, OAG and Audit New Zealand regarding their views on the next steps of the lease accounting project for the public sector – for the following reasons:

    (a) Staff considerations about the impost on the public sector from issuing PBE IPSAS 43 considering the rest of the NZASB work programme for the public sector, which includes projects on Revenue and Transfer Expenses – given that the transition to PBE IPSAS 43 will affect a large number of public sector entities and would have a significant accounting impact (as shown above under 'the lease accounting landscape in the public sector').

    (b) Our findings from considering public sector lease accounting requirements in other countries (see above) – i.e. the fact that Canada and South Africa have not adopted the ROU model in public sector accounting standards, and that the UK and USA have introduced simplifications/modifications to the ROU model that may be worth considering in New Zealand, but such consideration would take time.

    (c) The informal feedback we received about the lack of clarity around the benefits for users resulting from the introduction of the ROU model in the Australian public sector, outside of improving the management of leases internally – and the challenges of applying certain aspects of the IFRS 16-based requirements in the Australian public sector, such as challenges around impairing the ROU asset.

    (d) The anecdotal feedback that we have been receiving about the limited usefulness of IFRS 16 for certain users of financial statements in the for-profit sector (banks), and the challenges of applying IFRS 16 for for-profit preparers – and the fact that the IASB's PIR of IFRS 16 may uncover additional issues with the application of IFRS 16.

    (e) The fact that addressing the Treasury's comments on the ED about the scope of PBE IPSAS 43 could be addressed more efficiently once specific requirements for the accounting for concessionary leases have been considered and developed, in light of the IPSASB's future pronouncement on this topic.

    (f) Negative feedback received from the NFP sector via the survey for charities and funders (see the NFP-related section below) – while the public sector is distinct from the NFP sector, there are commonalities between the sector and the requirements in PBE Standards are generally the same for both sectors.

34. In our discussions with Treasury, OAG and Audit New Zealand in July 2023, we have asked the staff of the respective organisations about their views on the next steps for the PBE Leases project with respect to the public sector, i.e. considering the following options:

   (a) Option A: Issue PBE IPSAS 43 *Leases* 'now' (i.e. in the very near future), albeit still with a long effective date as proposed in the ED; or

   (b) Option B: Defer issuing PBE IPSAS 43 *Leases* until certain matters are resolved and additional information is obtained, i.e. until final decisions are made regarding the specific accounting requirements for concessionary leases; the scope of the Standard is considered further (as per the considerations recommended by Treasury in its ED submission); and more information is available on application issues in the for-profit sector as part of the PIR of IFRS 16 – and taking into account the full NZASB work programme for PBE Standards, which could result in major new standards affecting the public sector; or

   (c) Option C: Not to issue PBE IPSAS 43 at all.

Discussion with Treasury staff

35. Treasury staff's views were split between Option A ('issue now') and Option B ('defer issuing until certain matters are resolved and additional information is obtained') – ultimately leaning towards Option B.

36. The key points raised by Treasury staff are summarised below.

   (a) In the public sector, alignment with international accounting standards is important, as it enhances the independence and credibility of GAAP.

   (b) There are other benefits to introducing the ROU model:

      (i) Currently, the risk of structuring arrangements to achieve off-balance-sheet financing is not necessarily prevalent in the public sector, but nevertheless it remains a valid risk for the sector.

      (ii) Operational benefits: The ROU model is likely to encourage better management of leases in the public sector – and it is challenging to drive improvements to lease management systems without a standard that requires most leases to be recognised on the balance sheet.

      (iii) Workforce/capacity benefits: Keeping PBE Standards aligned with for-profit standards makes it easier for the public sector entities to hire accountants from the for-profit sector with minimal additional training costs. If PBE IPSAS 43 is not issued at all or is deferred for too long, it will become progressively harder for public sector entities to find accountants that are familiar with the 'old' lessee accounting model in PBE IPSAS 13 *Leases*.

(c) However, there are benefits to deferring the finalisation of PBE IPSAS 43 until the following public sector-specific matters are addressed:

  (i) Further consideration of which public sector arrangements are/should be in the scope of the Standard: It is important to address the Treasury's comments on the ED in relation to the scope of PBE IPSAS 43, i.e.:

  - Whether some concessionary leases that meet the definition of a lease as currently drafted should nevertheless be excluded from the scope of the Standard because their nature is different to a financing arrangement, or whether it makes sense to include them in the scope; and
  - whether the various rights-to-use arrangements in the public sector are in or out of scope.

  (ii) The finalisation of requirements for concessionary leases – issuing PBE IPSAS 43 together with finalised requirements for concessionary leases – as opposed to 'interim' requirements that are subject to change after the IPSASB finishes its project on concessionary leases – would make first-time application of PBE IPSAS 43 more efficient for public sector entities.

(d) Another benefit of deferring the finalisation of PBE IPSAS 43 is that it would reduce the impost on public sector entities at the time when they may be working on the implementation of other forthcoming major standards that are currently on the NZASB's work plan (e.g. Revenue and Transfer Expenses).

(e) There is also some merit in deferring the finalisation of PBE IPSAS 43 until the PIR of IFRS 16 is underway:

  (i) Deferring the finalisation of PBE IPSAS 43 until the completion of the IASB's PIR of IFRS 16 would be too long a deferral – and it is possible that the PIR may result in minimal changes to IFRS 16.

  (ii) However, the PIR of IFRS 16 may uncover certain application issues in the for-profit sector that may be worth addressing as part of finalising PBE IPSAS 43 for application by the public sector. Therefore, there is benefit in hearing the feedback from the for-profit sector on the PIR of IFRS 16 before finalising PBE IPSAS 43.

(f) Additional points in support of deferring the issuance of PBE IPSAS 43, provided that there is still a commitment to issue this Standard:

  (i) If the ROU model is never incorporated into PBE Standards or is deferred indefinitely, then over time, as more jurisdictions introduce ROU-based requirements for the public sector, there is a risk that international credit rating agencies may start to perceive the New Zealand public sector as an outlier. However, a decision to defer the finalisation of PBE IPSAS 43 with a clear plan for adoption would avoid this risk.

  (ii) For-profit public sector entities have been applying PBE IPSAS 13 for Crown reporting (and keeping two sets of lease accounting records) since 2019. The

Treasury assumes that those entities could continue their 'mixed group' reporting for consolidation purposes if issuance is deferred.

(iii) The UN's System of National Accounts does not yet incorporate the ROU requirements of IFRS 16/IPSAS 43.

(g) If issuance of PBE IPSAS 43 is deferred, it would be important to have a plan as to when the Standard is expected to be finalised, and to:

(i) Communicate this plan clearly to the public sector – to avoid losing the momentum of improving the management of leases and preparing for the new Standard; and

(ii) Ensure that the mandatory application date does not coincide with the mandatory application dates of other new major PBE Standards, e.g. Revenue and Transfer Expenses.

Discussion with OAG staff

37. OAG staff were supportive of Option B ('defer issuing PBE IPSAS 43 until certain matters are resolved and additional information is obtained').

38. The key points raised by OAG staff are summarised below.

(a) The Auditor-General's strategic intentions include a focus on influencing more meaningful and useful performance reporting to improve the performance and accountability of the public sector. It is this aspect of reporting in the public sector that currently needs more focus and effort compared to improvements to financial reporting.

(b) Issuing PBE Standards on Revenue and Transfer Expenses is considered a higher priority than issuing PBE IPSAS 43 *Leases*.

(c) It is preferrable to finalise PBE IPSAS 43 together with finalised requirements for concessionary leases (as opposed to finalising it with 'interim' scope clarification requirements that are subject to change after the IPSASB finishes its project on concessionary leases). Doing so would make first-time application of PBE IPSAS 43 more efficient for public sector entities.

(d) There is benefit in deferring the finalisation of PBE IPSAS 43 until the PIR of IFRS 16 is completed – because feedback on the PIR from for-profit entities could identify application issues that are worth addressing as part of the finalisation of PBE IPSAS 43.

Discussion with Audit New Zealand staff

39. Audit New Zealand staff did not have a strong view as to whether they preferred Option A ('issue PBE IPSAS 43 now') or Option B ('defer issuing PBE IPSAS 43 until certain matters are resolved and additional information is obtained')– but they were comfortable with Option B.

40. The key points raised by Audit New Zealand staff are summarised below.

(a) The current lease accounting requirements in PBE IPSAS 13 are not causing significant issues in the public sector, including from a 'mixed groups' perspective. Compared the new IPSASB standard on Transfer Expenses, which would help resolve inconsistency in practice that currently exists due to lack of specific requirements in PBE Standards, the need to bring in PBE IPSAS 43 is not as urgent.

(b) However, it is important to make sure that PBE IPSAS 43 is incorporated into PBE Standards at some point in the foreseeable future, and to set a clear plan for when this is expected happen, for the following reasons.

  (i) The proposals in ED PBE IPSAS 43 are good proposals from a public sector perspective, and the concerns from charities are not relevant to the decision of whether and when the Standard should be brought in for the public sector.

  (ii) Alignment with international standards is important for the public sector, in terms of how the New Zealand public sector is perceived internationally – so it is important that PBE IPSAS 43 is eventually introduced for the public sector.

(c) If finalisation of PBE IPSAS 43 is deferred, it is important to clearly articulate the reason for the deferral.

(d) There is some merit in deferring the finalisation of PBE IPSAS 43 until the PIR of IFRS 16 is underway, because comments from the for-profit sector on the application of IFRS 16 could provide useful information for finalising the development of PBE IPSAS 43 for the public sector. However, it is unnecessary to wait for the finalisation of the PIR (or for the IASB to amend IFRS 16 as a result of the PIR).

(e) It is not necessary to defer the issuance of PBE IPSAS 43 until the project on concessionary leases is finalised – that project could take a long time to finalise, and it is not a sufficient reason for deferring the Standard for leases that are not concessionary. However, if the matter of concessionary leases is causing challenges, one option could be to exclude concessionary leases from the scope of the Standard in the meantime.

(f) It is important to ensure that the mandatory date for applying PBE IPSAS 43 does not clash with the mandatory dates of applying the forthcoming standards, e.g. Revenue, and Transfer Expenses.

Staff recommendations for next steps: public sector

41. Based on the discussion in the previous sections, staff recommend to commit to the finalisation of PBE IPSAS 43 *Leases* for application by the public sector, but to DEFER the finalisation:

    (a) until certain matters are resolved and additional information is obtained – specifically, until:

        (i) The Board finalises the specific accounting requirements for concessionary leases;

        (ii) The Board considers further which public sector arrangements should be in the scope of the Standard; and

        (iii) The PIR of IFRS 16 is underway, so that we have more information from the for-profit sector on application issues relating to IFRS 16; and

    (b) taking into account holistically the full NZASB work programme for PBEs, including the expected timing of issuing other major new standards and these standards' application dates.

42. We acknowledge that alignment with international accounting standards is important to the New Zealand public sector, and feedback from the public sector on ED PBE IPSAS 43 has been broadly supportive. Therefore, we recommend committing to the finalisation of the standard, albeit that the finalisation should be deferred.

43. Taking into account the feedback we have heard, the following are the staff's main reasons in support of deferring the finalisation of PBE IPSAS 43:

    (a) It would be more efficient for public sector entities to adopt PBE IPSAS 43 together with finalised requirements for concessionary leases.

    (b) It is important to take time to appropriately address scope-related matters – including considering whether certain types of concessionary leases that meet the definition of a lease, but are dissimilar to financing arrangements, should be in the scope of the Standard, and whether certain public sector arrangements involving rights to use assets should be in or out of scope.

    (c) There does not seem to be an urgent need to issue PBE IPSAS 43, particularly compared to other areas on the NZASB work programme, e.g. Revenue and Transfer Expenses.

    (d) It is important to carefully consider the full NZASB work programme with respect to the public sector, including the priority level of forthcoming new standards and the expected implementation efforts for these standards, to understand the impost on public sector preparers – and to develop an appropriate timeline for the finalisation of PBE IPSAS 43 based on this understanding. It appears that the introduction of certain other forthcoming new standards on the NZASB work programme are of higher priority for the public sector as compared to PBE IPSAS 43 *Leases*.

    (e) The PIR of IFRS 16 could uncover application issues in the for-profit sector that would be useful to resolve for the benefit of the public sector as part of finalising PBE IPSAS 43, so there are benefits in waiting for this PIR to be underway.

(f) In deferring the finalisation of PBE IPSAS 43, New Zealand will not be the only country (among comparable countries) where ROU-based requirements are not yet included in public sector accounting standards – this is also the case for Canada and South Africa.

(g) Deferring the finalisation of PBE IPSAS 43 will give us the opportunity to learn from other jurisdictions as they assess current practice on lease accounting in the public sector.

44. We acknowledge stakeholders' comments about the importance of having a clear plan in place for finalising PBE IPSAS 43 for the public sector. The timing of finalising PBE IPSAS 43 for application by the public sector would depend on the factors outlined in paragraph 41 above, i.e. it would depend on the timing of major public sector-related project that are currently on the NZASB's work programme, the timing of finalising requirements on concessionary leases, and the timing of the PIR of IFRS 9.

45. While we are not able at this stage to determine specific dates for the plan to finalise PBE IPSAS 43 for the public sector, we consider that the factors outlined above are sufficient at this stage for providing clarity to the public sector around the finalisation of PBE IPSAS 43.

46. Once staff recommence work on PBE IPSAS 43 (considering the factors mentioned above), it would be important to ensure that all comments raised by respondents to ED PBE IPSAS 43 are considered prior to the finalisation of the Standard. For information purposes, the table below lists those specific matters raised by public sector respondents to ED PBE IPSAS 43 – and the status of these matters in terms of whether they have been considered/addressed in previous meetings, etc. The table also includes specific matters identified during the effects analysis with respect to the public sector, which would need to be considered ahead of finalisation. The table does not include the consideration of additional specific requirements on concessionary leases, as this is a separate project – although, as noted above, we recommend to finalise both projects together.

Table 3: Status of matters raised by ED respondents and other matters identified during the effects analysis – public sector

Comments raised by ED respondents/ matter arising from effects analysis	Status
Recommendation from MOE to clarify the wording of the requirements for sale and leaseback transactions – these requirements as drafted in the ED could imply that concessionary leaseback transactions need to be accounted for at fair value.	**Addressed – but reconsideration may be required in light of concessionary leases requirements** In May 2023, staff discussed with the Board suggested modifications to the sale and leaseback paragraphs in the draft Standard. The modifications aim to clarify that the fair value-related adjustments for sale and leaseback transactions do not apply to concessionary leaseback arrangements, i.e. ones where the lease payments are at below market terms and the substance of the lease is not commercial. The Board agreed with staff recommendations, subject to wording changes identified by the Board. However, if the Board agrees with staff's recommendation to defer the finalisation of PBE IPSAS 43, the updated sale and leaseback paragraphs will need to be considered again when final specific requirements for concessionary leases are developed.

Comments raised by ED respondents/ matter arising from effects analysis	Status
Recommendation from Treasury and OAG to consider additional disclosure concessions for Tier 2 PBEs	**Addressed – but reconsideration required due to external developments** In May 2023, staff discussed with the Board additional disclosures concessions for Tier 2 PBEs, which were broadly aligned with the proposed concessions in the IASB ED *Subsidiaries without Public Accountability: Disclosure*. The majority of the Board agreed with staff's recommendation for additional Tier 2 disclosure concessions. However: We note that after the May 2023 meeting, the IASB tentatively decided to change the lease-related disclosures in *Subsidiaries without Public Accountability: Disclosure.* Therefore, the Tier 2 disclosure concessions in PBE IPSAS 43 may need to be revisited at a future meeting.
Treasury's comments about the scope of the proposed standard, i.e. to consider whether certain concessionary leases that meet the definition of a lease should nevertheless be excluded from the scope of PBE IPSAS 43; and to consider a broader range 'right to use' arrangements in the public sector.	**Yet to be addressed** In May 2023, staff recommended that these comments should be considered after carrying out a more detailed effects analysis of the proposed Standard (and after the Board has had the opportunity to discuss the results of this analysis).
Recommendations from several respondents to specify a monetary threshold for 'low value' leased assets	
Recommendation from Auckland Council to specify that photocopiers/multi-function devices are generally considered to be 'low value' leased assets.	
Comment from PwC regarding the inconsistency between the proposed requirement in the ED to measure concessionary leases at cost, and the general requirement in PBE Standards to measure assets received in a non-exchange transaction at fair value.	**To be considered when determining requirements for concessionary leases** If the Board agrees with staff's recommendations in this memo, PBE IPSAS 43 would be finalised together with final specific requirements for concessionary leases – and PwC's comment would be considered as part of this process.
OAG's comment to make it clear in the Basis for Conclusions that until specific requirements for the accounting for concessionary leases are finalised, PBEs that currently account for concessionary leases at fair value can continue to do so.	**Deferral of finalisation of PBE IPSAS 43 resolves this matter** If the Board agrees to defer the finalisation of PBE IPSAS 43 for application by the public sector as per our recommendations, PBE IPSAS 43 will be finalised together with finalised requirements for concessionary leases.

Comments raised by ED respondents/ matter arising from effects analysis	Status
Consider simplifications with respect to impairment-related requirements, based on the observations from the Australian public sector.	**Yet to be addressed** Identified during the effects analysis
Consider other simplifications that other jurisdictions made when introducing the ROU requirement for the public sector.	**Yet to be addressed** Identified during the effects analysis

Question for the Board

Q1. Does the Board agree with staff recommendations to commit to finalising the PBE IPSAS 43 *Leases* for application by the public sector, but to defer the finalisation as explained above?

NFP sector

Not-for-profit sector lease accounting requirements in other countries

47. Similar to the approach we took for the public sector, we have considered the lease accounting requirements for NFP entities in Australia, the UK, the USA, Canda and South Africa.

48. As noted in the public sector-related section of this paper, the international analysis was not intended to be determinative in relation to the next steps of the PBE Leases projects for the NFP sector. The focus of our effects analysis is on the effects of PBE IPSAS 43 in New Zealand – and arguably, comparability with other jurisdictions is less important for the private NFP sector as compared to the public sector. However, we considered that information about the approach to lease accounting for NFP entities/charities in other countries would still be useful context for our effects analysis for the New Zealand public sector.

49. Our findings regarding the lease accounting requirements in the abovementioned countries are summarised below.

Table 4: NFP lease accounting requirements in other countries

Country	NFP sector lease accounting requirements		
	Lease accounting aligned with IFRS 16/IPSAS 43?	Are there any simplifications to the ROU requirements?	Comments on the scope of the ROU requirements
Australia	**Yes** NFP entities in Tier 1 and Tier 2 are required to apply the ROU model under AASB 16 *Leases* (effective for periods beginning on/after 1 January 2019)	**Yes:** • **Disclosure concessions:** There are disclosure concessions for public sector entities in Tier 2. • **Fair value measurement not required for concessionary leases** (but is permitted for leases with significantly below market terms). Additional disclosures apply to concessionary leases that are not measured at fair value.	• **Concessionary leases in scope – but fair value measurement not required** The scope of AASB 16 does not exclude leases at below-market terms; there are specific references to leases that have significantly below market terms (see the column to the left).

<table>
<tr><td rowspan="2">Country</td><td colspan="3">NFP sector lease accounting requirements</td></tr>
<tr><td>Lease accounting aligned with IFRS 16/IPSAS 43?</td><td>Are there any simplifications to the ROU requirements?</td><td>Comments on the scope of the ROU requirements</td></tr>
<tr><td>UK</td><td>Not yet, but proposals underway
The UK FRC proposed incorporating the requirements of IFRS 16 (with simplifications) into the standard FRS 102, which UK charities are required to comply with as part of the requirement to comply with SORP.</td><td>Yes – Exposure Draft 'FRED 82' includes the following proposed simplifications:
• Discount rate: As an alternative to the incremental borrowing rate, charities could use their <u>'obtainable borrowing rate'</u>, i.e. the rate at which they <u>could borrow the total amount of the lease payments over the lease term</u> – or the <u>interest rate on the charity's bank deposits</u>. If these rates cannot be readily determined, the charity could use the '<u>gilt rate' as published by the Bank of England</u>.
• Changes in lease payments: Changes in lease payments arising from a <u>change in an index/rate</u> can be <u>recognised in profit or loss, rather than requiring a recalculation of the lease liability and ROU asset</u>.
• Lease modifications: Compared to IFRS 16/IPSAS 43, there are <u>fewer situations in which a lease modification requires revising the discount rate</u>.
• Additional examples of low value/non-low value leased assets: The <u>list of examples is extended</u> as compared to IFRS 16/IPSAS 43, with <u>photocopiers mentioned as a typically low-value leased asset</u>.
• Transition: The <u>'modified retrospective approach' is mandated</u> when applying the IFRS 16 requirements for the first time, i.e. <u>'full retrospective' approach not available</u>.</td><td>• Concessionary leases proposed to be in scope – and market value measurement required (per proposals)
Leases with below-market terms are not excluded from the scope of the proposed 'leases' section in FRED 82. Under the proposals, <u>measurement based on market rentals is required</u> for the ROU asset in a lease obtained through a <u>non-exchange transaction</u>, where the <u>lease payments are significantly below market rent.</u></td></tr>
<tr><td>USA</td><td>Yes
NFP entities need to apply ASC 842 Leases, which is broadly aligned with IFRS 16 (with some modifications), starting from the 2022 calendar year.</td><td>Yes
• Simpler expense recognition: ASC 842 requires lessees to recognise most leases on the balance sheet, but <u>for the purpose of the expense recognition, a lessee still distinguishes between operating leases and finance leases</u> – and <u>for operating leases, the lessee recognises a single lease cost and does not need to separately recognise a finance expense and depreciation of the ROU asset</u>.
• Variable lease payments: A <u>change in variable lease payments that depend on an index/rate does not on its own trigger a requirement to remeasure the lease liability</u>.
• Sale and leaseback transactions: If the transaction is a sale, then <u>the seller-lessee can recognise the full gain on the sale</u> – i.e. the recognisable gain is not limited to just the portion that relates to the rights transferred to the buyer-lessee.</td><td>• Concessionary leases in scope – difference between fair value and actual lease payments accounted for as a contribution (i.e. the difference is not included within the ROU asset, but it still needs to be recognised separately).</td></tr>
</table>

Country	NFP sector lease accounting requirements		
	Lease accounting aligned with IFRS 16/IPSAS 43?	Are there any simplifications to the ROU requirements?	Comments on the scope of the ROU requirements
Canada	**No** – unless the entity chooses to apply IFRS. NFPs are required to apply either IFRS or Accounting Standards for Not-for-Profit Organisations (ASNPO). We understand that most NFPs report under ASNPO – where 'finance leases' are recognised on the balance sheet, but operating leases are not.	N/A	N/A
South Africa	**No** – unless the entity chooses to apply IFRS. NFPs are required to comply with 'GAAP', which is generally considered to be IFRS Standards, IFRS for SMEs, or a modified cash basis. We understand that most NFPs report under IFRS for SMEs – which does not include the lease accounting requirements of IFRS 16.	N/A	N/A

50. The following points are useful to note from the analysis above:

(a) Not all the countries that we looked at have incorporated ROU-based requirements into the accounting standards for NFPs. Canada and South Africa have not yet introduced these requirements for charities (unless a charity chooses to report under IFRS), and while the UK has proposed to introduce the ROU model for charities (with simplifications), these new requirements have not yet been finalised. This implies that if the Board were to decide not to introduce PBE IPSAS 43 for the NFP sector at this stage, the New Zealand NFP sector would not be seen as an 'outlier' with respect to international best practice for charities/NFP entities.

(b) The USA introduced simplifications to the ROU model as applicable to charities, and the UK's proposed ROU-based requirements also included simplifications for charities. Similar simplifications could be useful to consider in New Zealand, if and when PBE IPSAS 43 is introduced for application by NFP PBEs.

Survey for charities and funders

Background – the rationale for the surveys

51. As previously noted, NFP respondents to ED PBE IPSAS 43 (who were mainly Tier 2 charities) expressed concerns about the proposals, noting that the ROU requirements would be too costly and complex for charities to implement, and the costs of implementation would outweigh the benefits for charities and their users. There were also concerns that reporting on leases under the ROU model would be confusing for users of charities' financial statements. Furthermore, an argument was made that charities are different to the for-profit sector and the public sector, as they tend to have less access to resources compare to the other two sectors, and international alignment is not as important to charities compared to the other two sectors.

52. When we met with the ED respondents from the NFP sector, they continued to express and emphasise the concerns mentioned above. Furthermore, when we suggested possible simplifications to the ROU model, such as expressly allowing the use of published rates to discount lease payments, the respondents representing charities were of the view that these simplifications would not go far enough to alleviate their concerns.

53. In addition, an ED respondent noted that we have not received many submissions from charities on the ED, so there is a risk that many charities have not engaged with the proposals.

54. To check whether the concerns we heard from NFP ED respondents are representative of the NFP sector, and to understand further the expected costs and benefits from the application of the proposed PBE IPSAS 43 in the NFP sector, we designed two short surveys: a survey for charities, and a survey for funders of charities (representing users of charities' financial statements). We sought feedback on these surveys as part of the effects analysis of PBE IPSAS 43.

Survey questions

55. The survey questions for charities and for funders are shown below, in Figure 1 and Figure 2 respectively.

56. Both surveys included a brief introduction that referred to our consultation on ED PBE IPSAS 43 in 2022, noted that familiarity with the proposals is needed for completing the survey, and provided a link to the Consultation Document that accompanied the ED and to our 15-minute 'Walkthrough Webcast' relating to the consultation.

57. The questions for the charities aim to:

    (a) gain an understanding of the types of leases the charities in Tier 1 and Tier 2 typically hold – to help understand the extent of cost and complexity of applying PBE IPSAS 43;

    (b) check whether the costs and concerns that we heard about from ED respondents resonate with the wider Tier 1 and Tier 2 charities population; and

(c) check whether the expected benefits of PBE IPSAS 43 as per the 2022 Consultation Document resonate with the wider Tier 1 and Tier 2 charities population.

58. The questions in the survey for the funders aim to check:

(a) Whether the concerns that we heard about from charities with respect to the users of their financial statements resonate with funders; and

(b) Whether the expected benefits of PBE IPSAS 43 as per the 2022 Consultation Document resonate with funders.

59. Both surveys were anonymous. However, we have asked charities to identify whether they are in Tier 1 or Tier 2 for financial reporting purposes – as we considered that this information (plus the types of leases they have) would provide us with context for their responses.

Figure 1: Survey for Tier 1 and Tier 2 charities – questions

1) Please tell us what is the size of your charity:

(a) Annual expenses above $30 million (Tier 1)

(b) Annual expenses between $2 million and $30 million (Tier 2)

2) Please tell us about the types of leases you have.

Type of leased asset:	On average, how long is the lease term for this type of asset?	Are there rights of renewal?	How often does the rent change?	How often are other changes made to the lease agreement?
Land/ buildings	Multi-choice for each type of leased asset: • Less than 1 year • 1-2 years • 3-10 years • More than 10 years • N/A	Multi-choice for each type of leased asset: • Yes, one right of renewal • Yes, multiple rights of renewal • No rights of renewal • N/A	Multi-choice for each type of leased asset: • Several times per year • Once a year • Every few years • Never • N/A	Multi-choice for each type of leased asset: • Several times per year • Once a year • Every few years • Never • N/A
Vehicles				
Photocopiers				
Specialised equipment				
Other (please specify)				

3) Do you have any concerns relating to the proposed Leases standard? Please tick all answers that apply.

(a) The proposed standard is too complex.

(b) Applying the proposed standard will be costly - we will need to pay a third party or hire more staff.

(c) Recognising a lease liability on our balance sheet will make it look like we have taken on debt, and we are concerned about how this would look.

(d) I do not have any major concerns relating to the proposed standard.

(e) I have other concerns that are not mentioned above and/or I want to provide more detail about the concerns I selected above (please specify below).

Figure 1 Survey for Tier 1 and Tier 2 charities – questions (cont.)
4) In your view, which of the following benefits of the proposed Leases standard apply? [Please tick all answers that apply] (a) The balance sheet will give our funders and donors a more complete picture of our liabilities and the resources available to us. (b) Greater comparability between charities that 'borrow to buy' assets and those that lease assets. (c) Improved decision-making by management, due to increased visibility over leases. (d) Easier reporting for 'mixed groups' containing charities and for-profit entities. (e) Other (please specify). 5) How often are you asked to provide information about your charity's lease arrangements, over and above the information that you already report in the financial statements? (a) Often (b) Occasionally (c) Never 6) Do you have any other comments on the proposed new Leases standard?

Figure 2 Survey for funders – questions
1) The proposed Leases standard would require charities to recognise on the balance sheet a liability for making lease payments over the lease term, and an asset representing the right to use the leased asset, for most leases. Would this proposed change in reporting help you make funding decisions? (a) Yes (b) No Please provide more information about your answer. 2) What concerns do you have about the way charities currently report on their leases (as lessees)? [Please tick all answers that apply] (a) Since operating leases are currently not recognised on the balance sheet, the balance sheet does not give me a complete picture of charities' obligations to make payments in the future, so I need to make my own calculations. (b) Sometimes I don't get all the information I need about a charity's leases from the operating lease commitments note in the financial statements. (c) I have other concerns about the way charities currently report on leases (please specify using the textbox at the bottom).* (d) I do not have any major concerns about the way charities currently report on their leases. * If you have other concerns about the way charities currently report on their leases, please give us more information below

Figure 2 Survey for funders – questions (cont.)
3) Some charities expressed concerns about the proposed new Leases standard, in relation to the users of their financial statements. Do any of the following concerns resonate with you as a funder?[Please tick all the answers that apply] (a) The information that charities will provide about leases under the proposed standard will not be more helpful to me than the information they currently provide, i.e. the amount of operating lease expenses and lease commitments. (b) I would find it confusing to see interest and depreciation expenses related to leases under the proposed standard. It is easier for me to understand the lease expenses that charities currently report in their financial statements. (c) I have other concerns regarding the proposed Leases standard (please specify using the text box at the bottom).* (d) I do not have any major concerns regarding the proposed Leases standard. *If you have other concerns about the proposed new Leases standard, please give us more information below: 4) Do you have any other comments on the proposed new Leases standard?

Outreach on surveys

60. The surveys were open <u>from 15 June until 14 July 2023</u>.

61. We conducted the following outreach in relation to the surveys:

(a) Included an article about the surveys with links in the XRB newsletter (Pitopito Kōrero);

(b) Published LinkedIn posts encouraging charities and funders to respond to the surveys;

(c) Emailed individual charities (focusing on Tier 2 charities operating in the health and education sectors – because the concerns we heard from NFP ED respondents generally related to Tier 2 charities, and because our analysis showed that charities with health and education activities are likely to have material leases)

(d) Emailed individual funding organisations.

Results – survey for charities

<u>Number of respondents</u>

62. We received <u>88 responses</u> to the survey for Tier 1 and Tier 2 charities.

63. For context, during the consultation on ED PBE IPSAS 43 in 2022 we received comments from five representatives of the NFP sector, plus comments from an academic that covered NFP-related matters. As noted above, when we spoke to the NFP ED respondents in April 2022, a respondent highlighted a concern about the relatively low number of responses to the ED from the NFP sector. We believe that running the survey has helped us address this comment.

Respondents' size/reporting tier (Question 1)

64. Based on the responses to Question 1, the split between Tier 1 and Tier 2 among respondents was as follows (noting that one respondent (1%) did not indicate their reporting tier):

(a) 13% of respondents (11 charities) were in Tier 1; and

(b) 86% of respondents (76 charities) were in Tier 2.

Types of leases that charities have (Question 2)

65. Question 2 of the survey asked charities about the types of leases that they have. We asked charities what types of assets they lease, and for each type of leased asset, we asked how long is the average lease term, whether there are rights of renewal, how often does the rent change and how often are other changes made to the lease agreement.

66. We have asked these questions for two main reasons:

(a) To provide us with context for respondents' comments; and

(b) To gain an understanding of the types of leases the charities in Tier 1 and Tier 2 typically hold – to help understand the extent of cost and complexity of applying PBE IPSAS 43.

67. The table below summarises the types of leases that the respondents have. Please note that the percentages do not add to 100% due to respondents leasing more than one type of asset.

Table 5 Types of leased assets held by charities that responded to the survey (Question 2)

Leased asset type	Number of respondents that lease each type of asset	Percentage of respondents that lease each type of asset
Land/buildings	70	80%
Photocopiers	64	73%
Vehicles	27	31%
Specialised equipment	7	8%
Other type of leased asset	9	10%

68. 'Other types of leased assets' identified by respondents included car parks, computer hardware, staff laptops, phones, water coolers, EFTPOS machines, software leases, and music systems, as well as a lease for fitout of premises which was described as a finance lease. We note that some of the leased assets mentioned above may be exempt from the ROU requirements based on the examples and guidance in draft PBE IPSAS 43 – for example, phones and laptops are listed in the draft Standard as examples of 'low value' leased assets that would be exempt from the ROU requirements, and there is an accounting policy choice as to whether leases of intangible assets such as software are in the scope of the draft Standard.

69. Response relating to the lease terms for the different types of leased assets indicate the following.

Table 6 Information about lease terms (Question 2)

Question/topic	Results
On average, how long is the lease term?	The majority of leases held by the respondents had an average term of 3–10 years. This was the case for: • 69% of the land/building leases; • 81% of the vehicle leases; • 70% of the photocopier leases; • 57% of the specialised equipment leases; and • 67% of other leases.
Are there rights of renewal?	• For property leases (land and buildings), 93% of the leases were subject to one or more rights of renewal, with 67% of leases being subject to multiple rights of renewal. • For 'other leases', 57% were subject to one or more rights of renewal. • A significant percentage (but not the majority) of photocopier leases and specialised equipment leases – 38% and 33% respectively – were subject to one or more rights of renewal. • Most vehicle leases were not subject to rights of renewal.
How often does the rent change?	Below are the percentages of leases where the rent changes either once a year or every few years: • Property leases (land and buildings) – 89% (with 52% of leases having rent changes once a year). • 'Other' leases – in 53% • Specialised equipment – 50% • Photocopiers – 38%. • Vehicles – 28%.
How often are other changes made to the lease agreement?	Below are the percentages of leases where changes other than rent changes are made either once a year or every few years: • Property leases (land and buildings) – 48% • 'Other' leases – in 43% • Photocopiers – 33% • Vehicles – 32% For specialised equipment leased by the survey respondents, there are generally no changes to the lease agreement other than rent changes.

70. In term of the implications for the effects analysis, the responses to Question 2 indicate that in applying the proposed PBE IPSAS 43 *Leases*, many charities would need to consider the detailed requirements in the draft Standard regarding the assessment of renewal rights for the purpose of determining the lease term and the accounting for rent changes and other changes to the lease terms.

Concerns regarding the proposed new leases standard (Question 3)

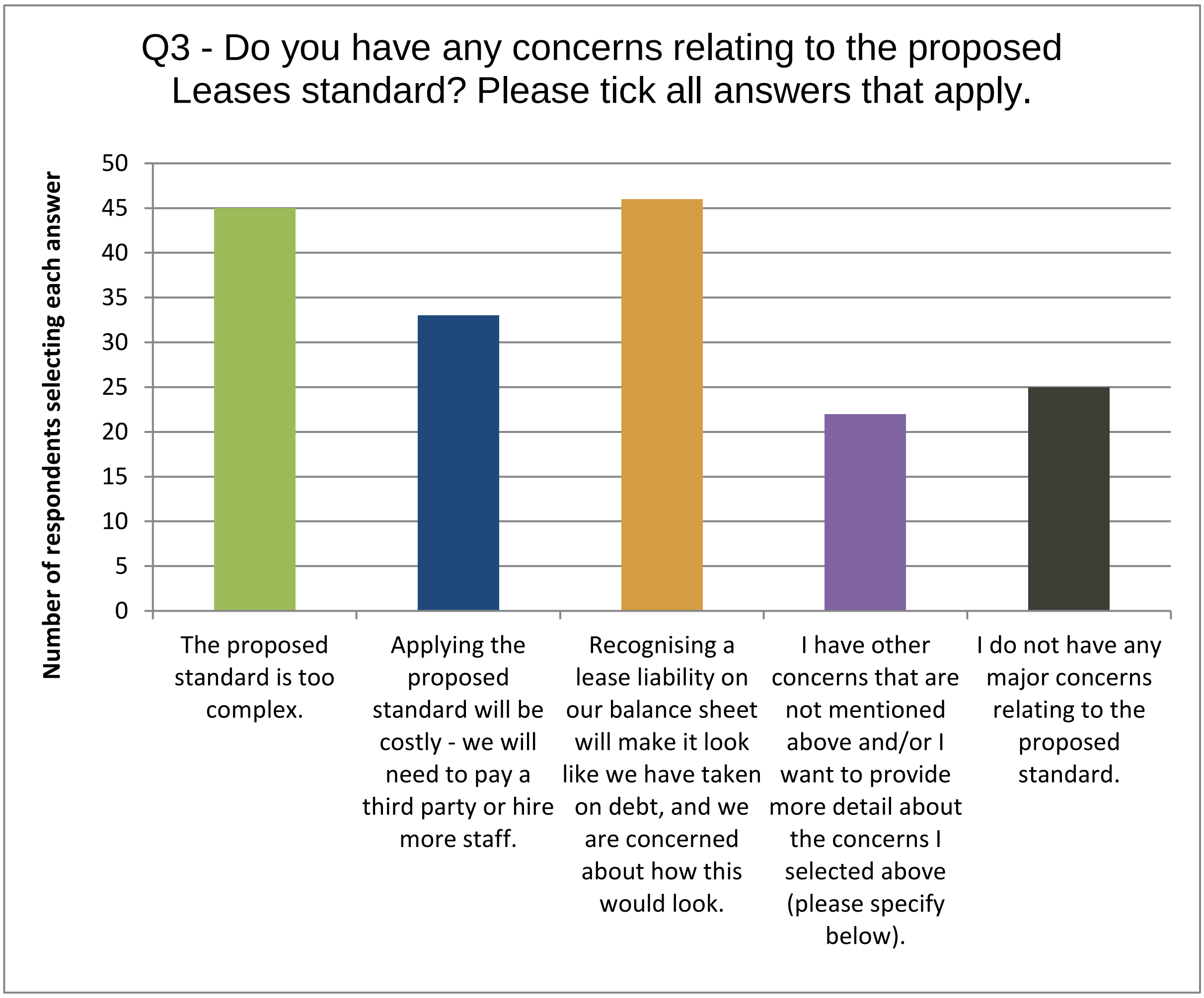
71. Question 3 asked respondents whether they have any concerns relating to the proposed new lease accounting standard.

72. Of the 88 survey respondents:

    (a) Only 28% (25 respondents) indicated that they do not have any major concerns in relation to the proposed standard.

    (b) The remaining 72% (63 respondents) indicated that they have one or more of the concerns provided as multi-choice options, which were based on the concerns that we heard from the NFP respondents to ED PBE IPSAS 43.

73. The responses to Question 3 are summarised in the graph below.



74. We have further analysed the above responses by reporting tier. Acknowledging that the majority of respondents were in Tier 2, our analysis nevertheless indicates that the percentage of charities that have/ do not have concerns regarding the proposed PBE IPSAS 43 are similar across both tiers, i.e.:

    (a) Of the 11 Tier 1 respondents, 28% indicated that they did not have significant concerns in relation to the proposed PBE IPSAS 43, whereas the remaining 72% had concerns.

    (b) Of the 76 Tier 2 respondents, 27% indicated that they did not have significant concerns in relation to the proposed PBE IPSAS 43, whereas the remaining 73% had concerns.

75. For those respondents that selected the option 'I have other concerns that are not mentioned above and/or I want to provide more detail about the concerns I selected', the following were the 'top 5' most common themes (by number of respondents) arising from these respondents' narrative comments:

    (a) The proposed ROU requirements would result in no benefits or little benefit for users of charities' financial statements (7 respondents).

    (b) Users of charities' financial statements will be confused by the reporting that will result from the ROU model (7 respondents).

    (c) Further details about cost-related and complexity-related concerns in the multi-choice options – specifically mentioning administration costs, audit costs, and compliance costs in general, and/or concerns of increased staff workload that would be required to implement the proposals (7 respondents).

    (d) View that operating leases should not be recognised on the balance sheet because leasing an asset via operating lease is dissimilar to ownership of an asset (4 respondents).

    (e) There is no problem with the current lease accounting requirements – they result in sufficient information being provided in the financial statements (3 respondents).

76. The implications for the effects analysis from the responses to Question 3 are as follows:

    (a) Based on the survey results, the concerns expressed by the NFP stakeholders who responded to our 2022 ED – i.e. concerns regarding the cost and complexity of the ROU model for NFP entities and that the costs would not be justified by benefits for users in the NFP sector – appear to be prevalent among the wider population of Tier 1 and Tier 2 charities.

    (b) While the majority of survey respondents were in Tier 2, the percentage of respondents who had concerns about the proposed PBE IPSAS 43 was similar to the percentage of Tier 2 entities that had concerns about the proposals – indicating that concerns about the costs and/or complexity of the standard and its usefulness to users of financial statements are also relevant to Tier 1 charities.

Benefits of the proposed PBE IPSAS 43 (Question 4)

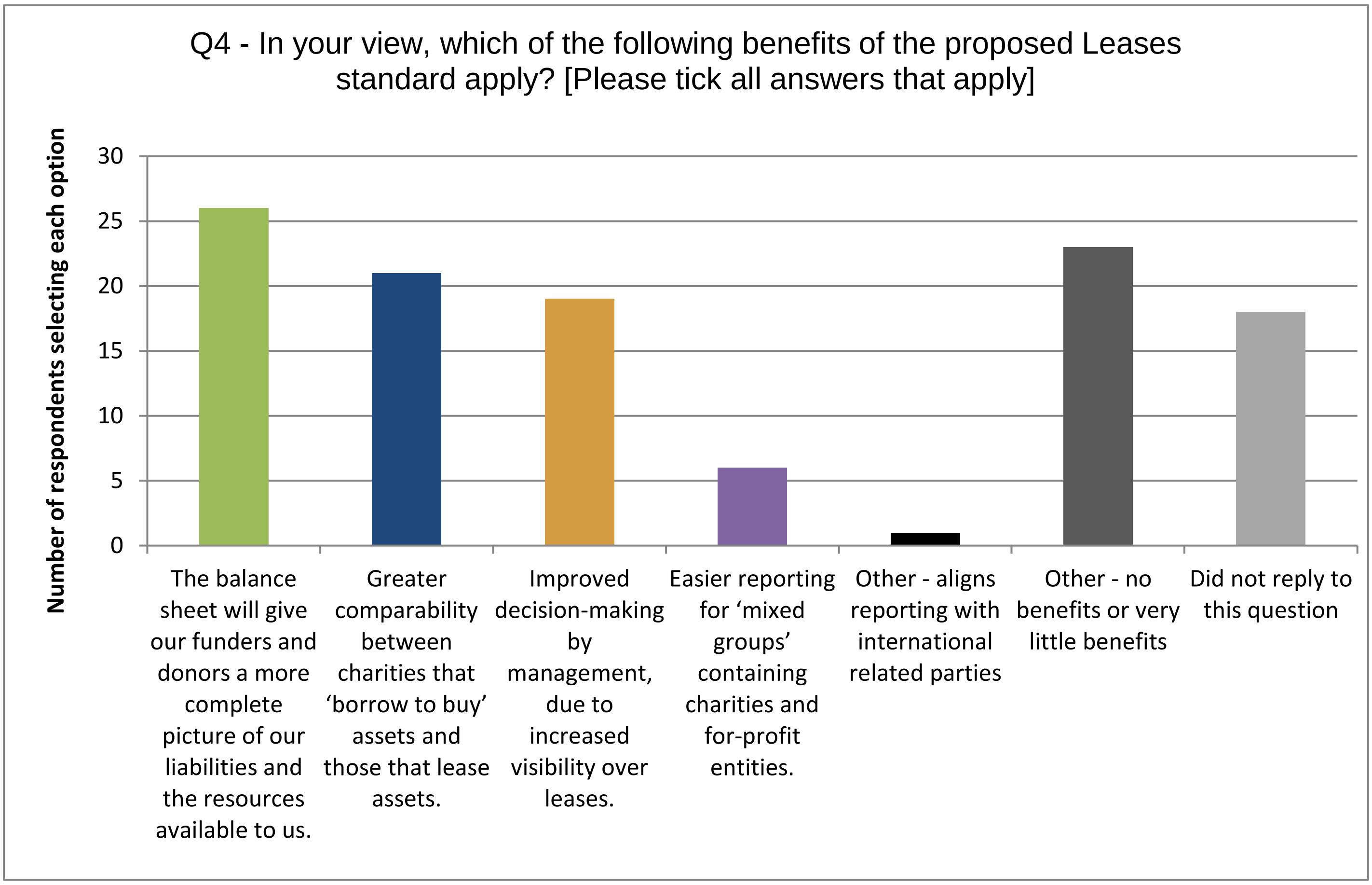
77. Question 4 presented charities with four expected key benefits of PBE IPSAS 43, and asked which of these benefits apply in the respondent's view.

78. Of the 88 respondents:

(a) About 47% (41 respondents) either selected the option 'other' and commented that they see no benefits or very little benefits, or did not answer this question (which in our understanding implies that these respondents did not see benefits in the proposals).

(b) The remaining 53% of respondents (47 respondents) selected one or more of the suggested benefits, which were based on the key benefits outlined in the 2022 Consultation Document, with one respondent mentioning an additional benefit under the option 'other'.

79. The responses to Question 4 are summarised in the graph below.



80. The implications for the effects analysis from the responses to Question 4 are as follows:

(a) A narrow majority of respondents agreed that the proposals would bring about one of more of the expected benefits outlined in the 2022 Consultation Document accompanying ED PBE IPSAS 43 – including the balance sheet giving funders a more complete picture of charities resources and obligations.

(b) However, the abovementioned majority is narrow, with almost half of respondents either not identifying benefits or specifically stating that are no or little benefits from the proposed PBE IPSAS 43. This fact, coupled with the fact that over 70% of respondents had concerns about the proposed standard, seems to indicate that for the population of charities that responded to the survey, overall the concerns in relation to the proposed ROU model appear to outweigh the benefits.

How often are charities asked for additional information on leases under the current requirements (Question 5)

81. Question 5 asked respondents how often they were asked to provide additional information about their lease arrangements, over and above the information that is currently reported in the financial statements under current lease accounting requirements.

82. The question was intended to gauge whether current lease accounting requirements provide enough information for users of financial statements. If charities are often asked for additional information on their lease arrangements, this would be an indicator that current lease accounting requirements are not providing users of charities' financial statements with the information they need on this topic.

83. Of the 88 respondents, 75% (66 respondents) said that they are never asked for additional information on their lease arrangements, and 25% (22 respondents) said that they are *occasionally* asked for additional information. None of the respondents said that they are often asked for additional information on leases.

84. The implication of the responses to Question 4 is that it appears that the current lease accounting requirements are not causing an urgent issue in terms of user needs in the not-for-profit sector.

Other comments on the proposals (Question 6)

85. Question 6 asked respondents for any other comments on the proposed PBE IPSAS 43. Of the 88 respondents, 31 respondents provided additional comments on the proposals.

86. Five of the additional comments were positive. They included the following comments:

(a) Two respondents, one in Tier 1 and the other in Tier 2, said that the proposals would not be difficult to apply in general – and one additional respondent in Tier 1 said that the proposals would not be difficult to apply for Tier 1 charities (but would be more challenging for Tier 2 charities).

(b) Two respondents commented on the benefits of the proposals -one noting that the proposals have merit, and the other one noting that the proposal would help achieve better operational capacity and equity management.

87. One respondent made a neutral comment, asking for more training and webinars once the proposed standard becomes mandatory.

88. The rest of the comments expressed concerns about the proposals. The 'top 5' themes by number of respondents were:

    (a) Concerns about costs and complexity – the ROU model will be costly to apply and/or the proposals are overly complex for charities and/or the cost of applying the proposals would mean that charities have less resources to help the communities that they service (11 respondents).

    (b) There is no problem with the current lease accounting requirements – they result in sufficient information being provided in the financial statements (7 respondents).

    (c) Concerns about the application of the proposals for Tier 2 charities – the ROU model would be particularly challenging to apply for Tier 2 charities, the costs and benefits do not stack up for Tier 2, etc. (6 respondents).

    (d) The proposals will result in no benefits/little benefit for users of charities' financial statements and/or the expected benefits of the proposals are not relevant to users of charities financial statements (5 respondents).

    (e) Reporting on leases under the ROU model would be confusing to users of charities' financial statements (4 respondents).

89. The responses to Question 6 seem to re-iterate the abovementioned implication that Tier 1 and Tier 2 charities are <u>concerned about the costs and complexity of the ROU model for charities</u>, and that there are <u>questions around the benefits and usefulness</u> of the proposed requirements for users of charities' financial statements.

Survey results – funders

<u>Number of respondents</u>

90. We received survey responses from <u>five funders</u>.

91. We acknowledge that the number of responses from funders is much lower than the number of responses from charities. However, we note that the number of funding organisations is significantly smaller than the total number of charities in Tier 1 and Tier 2.

92. We also note that during the consultation on ED PBE IPSAS 43 *Leases* in 2022, we did not receive any submissions from funders. Therefore, receiving survey responses from five funders is useful, as it gives us information about the funders' perspective directly from funders, which we did not previously have.

<u>Summary of responses</u>

93. The responses from funders are summarised below.

Table 7 Summary of survey responses from funders

Q1. The <u>proposed</u> Leases standard would require charities to recognise on the balance sheet a liability for making lease payments over the lease term, and an asset representing the right to use the leased asset, for most leases. Would this proposed change in reporting help you make funding decisions?	
• No – <u>4 funders</u> Reasons: ○ One funder noted that information about leases is already provided in the notes to the financial statements under the current accounting requirements. ○ Another funder said that if operating leases are material, the funder asks for and receives additional information directly from the charity. ○ A third funder said that they make funding decisions based on the cause that a charity works – not based on the charity's balance sheet.	• Yes – <u>1 funder</u> Reason: The proposed standard would give greater visibility over the charity's exposure to obligations
Q2. What concerns do you have about the way charities <u>currently</u> report on their leases (as lessees)? [Please tick all answers that apply]	
<u>Options</u> • I do not have any major concerns about the way charities currently report on their leases	<u>Number of funders:</u> • 3 funders
• Since operating leases are currently not recognised on the balance sheet, the balance sheet does not give me a complete picture of charities' obligations to make payments in the future, so I need to make my own calculations	• 1 funder
• Sometimes I don't get all the information I need about a charity's leases from the operating lease commitments note in the financial statements	• 1 funder
Q3. Some charities expressed concerns about the proposed new Leases standard, in relation to the users of their financial statements. Do any of the following concerns resonate with you as a funder? [Please tick all the answers that apply]	
<u>Options:</u> *[note: one respondent selected several options]* • The information that charities will provide about leases under the proposed standard will not be more helpful to me than the information they currently provide, i.e. the amount of operating lease expenses and lease commitments	<u>Number of funders:</u> • 3 funders
• I would find it confusing to see interest and depreciation expenses related to leases under the proposed standard. It is easier for me to understand the lease expenses that charities currently report in their financial statements	• 2 funder
• I have other concerns regarding the proposed Leases standard (please specify) ○ Concern that the proposed standard will add costs and complexity for charities, who have limited resources – for not much benefit.	• 1 funder
• I do not have any major concerns regarding the proposed Leases standard	• 1 funder

Q4. Do you have any other comments on the proposed standard?

Two funders provided comments under this section.
• Both funders were concerned about the compliance costs for charities.
• One funder noted that the proposals are technically correct, but they will be costly to implement for charities, which will leave charities with fewer resources to help those in need – and the current lease accounting requirements are 'not broken'.
• The other funder made the following points:
  o Recognising a ROU asset and a lease liability would provide greater transparency around leases on the balance sheet, but funders will invariably need to look beyond the balance sheet to get a 'complete picture' when making funding decisions, regardless of whether ROU requirements are introduced.
  o The concept of an ROU asset is confusing for non-accountants.
  o Even if the ROU requirements are introduced, it would still be necessary for funders to 'recalculate the balance sheet' in some cases, given that the ROU asset cannot be sold or used as collateral.
  o For charities, it is better for the lease accounting model to be aligned with cash flow principles.
  o It is good that the proposals do not require fair value measurement for concessionary leases.

94. In summary:

(a) <u>Some of the funders </u>that responded to our survey<u> saw benefits</u> in the proposed ROU-based leased accounting model or <u>acknowledged its technical merits</u>.

(b) <u>However, most of the funders</u> <u>did not think that the proposed new lessee accounting model would help them make funding decisions</u>, and most of them <u>had concerns about the usefulness of the information </u>that would be reported under the proposals (as well as concerns relating to the costs for charities).

Staff recommendations for next steps – NFP sector

95. The results of our surveys for Tier 1 and Tier 2 charities and funders have highlighted concerns in the NFP sector regarding the cost and complexity of applying the ROU-based leased accounting requirements in draft PBE IPSAS 43, as well as concerns about the usefulness of the information that would be reported under PBE IPSAS 43 for users of charities' financial statements. While some survey respondents saw benefits in the proposals, the majority of respondents expressed the abovementioned concerns. Furthermore, based on the survey responses, the current lease accounting requirements are not causing major issues in the NFP sector.

96. In light of these results, we recommend that the Board agrees to <u>commit to the current lessee accounting model for NFP PBEs </u>(whereby finance leases are recognised on the balance sheet but operating leases are not) – with a view <u>to reassess whether current practice remains appropriate after public sector PBEs have adopted the ROU model , having regard to learning from application by public sector PBEs and considering feedback from NFP stakeholders at the time</u>.

97. We note that there is precedent for departing from an IPSASB-based requirements for NFP PBEs for cost-benefit reasons. Specifically, the amending standard *Donated Goods* (Amendments to PBE IPSAS 23), issued in January 2016, amended PBE IPSAS 23 *Revenue from Exchange and Non-exchange Transactions* to allow PBEs not to recognise donated inventory at fair value if it is not practicable to determine fair value due to the costs of doing so outweighing the benefits. This New Zealand amendment to the IPSASB-based requirement in IPSAS 23 was made due to concerns from the NFP sector that when NFPs receive large volumes of inventory consisting of individually low-value items, the requirement to determine the fair value of the donated inventory would result in significant costs and the resulting information would be of limited usefulness.

98. We acknowledge that our recommendations in this memo will result in different lease accounting requirements for public sector PBEs as compared to NFP PBEs (once PBE IPSAS 43 is finalised for application by public sector PBEs). However:

    (a) As previously discussed with the Board, while PBE Standards generally have the same requirements for public sector PBEs and NFP PBEs, the New Zealand Accounting Standards Framework and the PBE Policy Approach do not prevent the Board from having different requirements for public sector PBEs compared to NFP PBEs.

    (b) We consider that it is important to take into account the difference in feedback received from the public sector and NFP sector regarding the proposed ROU model.

    (c) If the Board agrees with our recommendations, a reassessment of whether current practice remains appropriate for NFP PBEs will occur after the public sector has adopted the ROU model.

99. We note that if the Board agrees with the decision above, the New Zealand NFP sector would not be an international 'outlier' at this stage – given that charities in Canada and South Africa are not required to apply the ROU model to leases, and while there are proposals to require this model for UK charities these proposals have not yet been finalised. On a similar note, it is useful to note that the IASB decided not to include the ROU model as per IFRS 16 into the *IFRS for SMEs* at this stage due to cost-benefit concerns. In any case, alignment with international accounting requirements does not seem to be of high importance to charities as compared to public sector PBEs and for-profit entities.

100. We think it is important and appropriate to reconsider whether to introduce the ROU model for NFP PBEs after this model has been adopted by public sector PBEs. By that time, due to changes in environmental factors, such as the accounting workforce's experience with the ROU model, other changes within the suite of PBE Standards, etc., it may be that the cost/benefit considerations will have changed in the NFP sector. For example, it may be that in five years' time, most New Zealand accountants will only be familiar with the ROU model for lessees, which could make it costly for NFPs not to adopt the ROU model. Furthermore, NFP PBEs will be able to use the learnings from public sector PBEs that will have adopted the ROU model, which might make it easier and less costly to apply the ROU requirements at that time.

Question for the Board

Q2. Does the Board agree with staff recommendations to commit to current practice in terms of the lease accounting model for NFP PBEs, with a view to reconsidering whether this remains appropriate after the public sector has adopted PBE IPSAS 43 *Leases*?

Next steps

101. If the Board agrees with staff recommendations, staff will:

   (a) communicate the Board's decisions to stakeholders; and

   (b) monitor the timelines of other major public sector-related projects on the NZASB's work programme, the IPSASB's work on concessionary leases and the PIR of IFRS 16 in order to determine when to recommence work on draft PBE IPSAS 43 *Leases* for application by the public sector.

Appendix 1A: PBE Leases project timeline

Date	Project activity
Jan 2018	IPSASB issues IPSASB ED 64 *Leases* – which includes lessee accounting proposals aligned with IFRS 16 *Leases*, but also proposals to introduce the ROU model for lessors, and proposals for the fair value measurement of concessionary leases.
Feb-May 2018	XRB carried out broad outreach in New Zealand on IPSASB ED 64 (including roundtables, etc.) Feedback indicated broad support for the proposed ROU model for PBE *lessees*, except in relation to concessionary leases and other lease-type arrangements
Jun 2018	NZASB submitted comments on IPSASB ED 64 *Leases*
Jan 2021	IPSASB issued IPSASB ED 75 *Leases* – proposals aligned with IFRS 16 *Leases* (for lessees and lessors) Separate Request for Information (RFI) issued on *Concessionary Leases and Other Arrangements Similar to Leases*
Feb 2021	XRB carried out broad outreach in New Zealand on IPSASB ED 75 *Leases* and received feedback on the RFI
May 2021	NZASB submitted comments on IPSASB ED 75 *Leases* and the RFI
Jan 2022	IPSASB issued IPSAS 43 *Leases* – aligned with ED 75 proposals and IFRS 16 No specific requirements for concessionary leases, and public sector arrangements that are similar to leases are scoped out – considered separately under the project *Other Lease-type Arrangements*.
Feb 2022	NZASB applied the PBE Policy Approach and agreed that it should propose incorporating the requirements in IPSAS 43 into PBE Standards – and not wait for the project on concessionary leases and public sector arrangements that are similar to leases to be completed. The NZASB agreed in principle to allow for a long effective date to enable PBEs the option to adopt the new lease accounting requirement early (this was considered important for mixed group entities).
Apr 2022	NZASB discussed whether to make certain modification to IPSAS 43 – to enhance the appropriateness and usefulness of this standard for New Zealand PBEs and the users of their financial statements
Jun 2022	NZASB discussed a working draft of the ED and Consultation Document
August 2022	**NZASB APPROVED ED PBE IPSAS 43 *Leases* and Consultation Document for publication**
Aug–Nov 2022	Staff undertook outreach activities – including publicising the consultation in our newsletter and on LinkedIn, recording and publishing a 'walkthrough webcast' on the consultation, reaching out to key PBE stakeholders.
25 Nov 2022	**Consultation closed – 11 formal and informal submissions received**
Dec 2022 – Jan 2023	Staff analysed feedback received on the EDs
Jan 2023	IPSASB issued ED 84: *Concessionary Leases and Other Lease-type Arrangements*
Feb 2023	• NZASB discussed its approach to IPSASB ED 84: *Concessionary Leases and ROU Assets In-kind* • Staff presented analysis of feedback received on ED PBE IPSAS 43 *Leases* and sought NZASB's strategic direction for this project. NZASB agreed: o not to defer the publication of PBE IPSAS 43 until NZ requirements for concessionary leases are developed; and o that staff should explore practical expedients in relation to the ROU model, focusing on not-for-profit PBEs in the first instance (narrow majority, with the Board having split views).
May 2023	• NZASB agreed to make certain modification to PBE IPSAS 43 based on ED feedback – namely, to clarify the sale and leaseback requirements and increase RDR concessions for Tier 2. • NZASB agreed that staff should carry out detailed effects analysis regarding PBE IPSAS 43, before determining next steps.

Date	Project activity
This meeting	Staff seeking NZASB agreement to: • Commit to the finalisation of PBE IPSAS 43 for application by the public sector, but defer finalisation until certain matters are addressed and additional information is available, and taking into account the timing of other major public sector-related projects on the NZASB work programme; • Commit to current lease accounting practice for NFP PBEs, with a view to reassess whether it remains appropriate after PBE IPSAS 43 has been adopted in the public sector.
FUTURE:	
2024-2026	Staff to monitor the timing of the development of other major PBE Standards on the NZASB's work plan, the IPSASB's work on concessionary leases and the IASB's PIR of IFRS 16 – and to determine when to recommence work on the finalisation of PBE IPSAS 43 for application by the public sector. When this work recommences, staff will consider how to address the remaining matters raised by public sector respondents to ED PBE IPSAS 43, as well as other matters that arose during the effects analysis with respect to the public sector.

Appendix 1B: Summary of ED PBE IPSAS 43 and the accompanying Consultation Document

<table>
<tr><td>ED
(To view the ED in full, click here)</td><td>

Main proposal: PBE lessees to account for most leases using the ROU model, where the lessee recognises on the balance sheet:

a lease liability, representing the obligation for the future lease payments (based on lease payments discounted to present value); and
a ROU asset, representing the right to use the leased asset for a specified period of time (based on the lease liability with adjustments where relevant)

Exemptions from the ROU model for lessees:

Short-term leases (lease term shorter than 12 months); and
Leases of low-value assets (consistent with IPSAS 43, ‘low value’ is determined for each individual leased asset and on absolute basis, examples are provided but a monetary threshold is not indicated).

Proposals are based on IPSAS 43 Leases, with limited NZ modifications:

Clarification for concessionary leases (see below);
RDR concessions for Tier 2 PBEs, aligned with Tier 2 for-profit RDR concessions in NZ IFRS 16;
Minor modification to align with PBE Standards terminology and to take into account differences between IPSAS and PBE Standards (e.g. consequential amendments to those PBE Standards that are not based on IPSAS, etc).

NZ clarification for concessionary leases:

Concessionary leases that meet the definition of a lease are within the scope of the proposed Standard;
However, concessionary leases are accounted for based on the lease payments as per the lease agreement (rather than the payments that would have been charged had the lease been at market terms);
Furthermore, concessionary leases and arrangements to use an asset for a specified period for no consideration are excluded from the scope and fair value measurement requirements of PBE IPSAS 23.
The above clarifications will be reconsidered once the IPSASB finalises its project on Concessionary Leases and Other Lease-type Arrangements

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<tr><td>Consultation Document
(To view the document in full, click here)</td><td>

Highlighted the benefits of the proposals, including:

International alignment with IPSASB and IASB – allowing PBEs to benefit from the latest international thinking on lease accounting.
Greater transparency around leases in lessees’ financial statements,
Easier reporting for ‘mixed groups’ containing PBEs and for-profit entities (due to alignment with NZ IFRS 16).

Asked specific questions about:

The proposed New Zealand clarification for concessionary leases (see above);
Whether to modify the IPSASB’s requirements for low-value leased assets (no modifications proposed in the ED);
The proposed RDR concessions (see the left column);
The proposed ‘long’ effective date – 1 January 2027; and

Any other comments on the ED.

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Appendix 1C: Summary of ED feedback

We have received formal and informal/online submissions on ED PBE IPSAS 43 *Leases* from 11 respondents. The respondents and a high-level summary of their response is shown below. In summary, the responses indicate that:

(c) from a public sector perspective, there is general support for incorporating IPSAS 43-based requirements into PBE Standards, with some suggested refinements and additional considerations – and with some concerns regarding concessionary leases;

(d) By contrast, NFP respondents have concerns that the proposed requirements are overly complex and the cost of applying them would outweigh the benefits for NFP PBEs and the users of their financial statements.

#	Respondent name	Respondent type	General direction of response	Summary of response by question/topic
Formal submissions				
R1	Auckland Council	Public sector PBE preparer, Tier 1	Supports the proposed new Standard in general, with some recommended amendments	• Supports the scope clarification for concessionary leases (and would not support fair value measurement for concessionary leases) • Supports the low-value leased asset exemption being determined on an absolute basis for each individual asset, but recommends: ○ adding a monetary threshold for low value; and ○ specifying that photocopiers are low-value leased assets. • Supports the proposed RDR concessions. • Supports the proposed effective date of 1 Jan 2027.
R2	Charities Services	Charities regulator	Passed on comments from its constituents (charities) – who generally do not support the proposed new Standard	Charities Services' constituents noted that the proposed requirements are complex and the costs would exceed the benefits for charities. (Respondent did not answer the specific questions in the Consultation Document)

#	Respondent name	Respondent type	General direction of response	Summary of response by question/topic
R3	New Zealand Family Planning	NFP PBE preparer, Tier 2	Does not support the proposed new Standard for NFPs (particularly Tier 2 NFPs such as itself)	Considers the proposed requirements to be complex and that the costs would exceed the benefits for NFPs. (Respondent did not answer the specific questions in the Consultation Document)
R4	Ministry of Education	Public sector PBE preparer, Tier 1	Supports the proposed new Standard in general, with some recommended amendments	• Supports the scope clarification for concessionary leases – but, raises an issue relating to sale and leaseback transactions (the sale and leaseback requirements as currently drafted could be read as requiring the recognition of the ROU asset arising from a leaseback at fair value); • Supports the low-value leased asset exemption being determined on an absolute basis for each individual asset – but, recommends adding a monetary threshold. • Supports the proposed RDR concessions. • Supports the proposed effective date of 1 Jan 2027. • Makes additional recommendations, e.g. around the Treasury setting discount rates. • Would not support fair value measurement for concessionary leases.
R5	OAG	Public sector agency	Supports the proposed new Standard in general, with some recommended changes	• Supports the scope clarification for concessionary leases, but: o Recommends clarifying in the BC that PBEs who currently measure concessionary leases at fair value can continue this practice until PBE IPSAS 43 becomes effective and specific requirements for concessionary leases are developed. • Supports the low-value leased asset exemption being determined on an absolute basis for each individual asset. • Supports the proposed RDR concessions for now – but suggests revisiting the suite of RDR concessions at a later stage. • Supports the proposed effective date of 1 Jan 2027.

#	Respondent name	Respondent type	General direction of response	Summary of response by question/topic
R6	PwC	Accounting firm – various clients	Supports the proposed new Standard in general, with some recommended amendments	• Supports the scope clarification for concessionary leases in general, but: ○ Notes that the scope clarification for concessionary leases is inconsistent with the general principle of PBE IPSAS 23 to use fair value measurement for non-exchange transactions wherever possible; and ○ Is concerned that the scope clarification for concessionary leases would provide structuring opportunities for entities wanting to avoid the fair value requirements of PBE IPSAS 23. • Supports the low-value leased asset exemption being determined on an absolute basis for each individual asset- but, recommends adding a monetary threshold for low-valued leased assets. • Supports the proposed RDR concessions. • Supports the proposed effective date of 1 Jan 2027.
R7	The Treasury	Public sector agency – and public sector preparer, Tier 1 (NZ Government)	Supports the proposed new Standard in general, with some recommended amendments, with the understanding that this Standard represents an 'interim' step and concessionary leases are yet to be considered. Recommends deeper and broader consideration of concessionary leases and lease-type arrangements in Phase 2 of the project.	• Supports the scope clarification for concessionary leases, but as an interim solution only – with further work to be performed regarding concessionary leases and lease-type arrangements (see below). • Supports the low-value leased asset exemption being determined on an absolute basis for each individual asset – but, recommends adding a monetary threshold. • Recommends further RDR concessions for Tier 2 PBEs. • Supports the proposed effective date of 1 Jan 2027. • Recommends deeper and broader consideration of concessionary leases and lease-type arrangements as part of Phase 2 of the project – specifically, to consider the following: ○ <u>Consider whether certain concessionary leases that *meet the definition of a lease* should *nevertheless be excluded from the scope of PBE IPSAS 43:*</u> This is because the IFRS 16-based ROU model is based on the '*foundational presumption*' *that leases are financing arrangements*, whereas many concessionary leases are *not financing arrangements*, even though they meet the definition of a lease as per ED PBE IPSAS 43. The Treasury considers that "characterising a concessional lease as an operating subsidy is a more fair reflection of its economic substance than reporting it as a financial obligation". ○ <u>Consider *broader range 'right to use' arrangements* (which might not meet the definition of a lease) that the public sector is involved in:</u> The Treasury note that in the public sector, there are various 'rights to use' arrangements relating to property that involve transferring rights to a lessee, or to a proprietor/kaitiaki, or to a lessee. These rights may include a right to use the asset and direct its use, or just to use the asset but not direct its use, or both types of rights. The Treasury recommends taking a holistic approach to the development of financial reporting requirements for public sector arrangements that involve the transfer of rights over property (which may or may not meet the definition of a lease as per PBE IPSAS 43).

#	Respondent name	Respondent type	General direction of response	Summary of response by question/topic
Online feedback				
R8	Professor Tom Scott, AUT	Academic	Shared research findings indicating that the proposals would result in benefits without material costs for Councils (public sector PBEs), but for charities there would be a material impact in terms of costs and challenges	Research indicates that: • For local councils (public sector PBEs), the proposed requirements would result in more information in the financial statements without material costs, and may be beneficial for those councils that access debt markets. • However, the proposed requirements would materially affect charities through both technical accounting challenges and operational challenges. ○ Technical challenges could arise due to difficulties in determining the discount rate, particularly given that charities tend to not have borrowings. ○ Operational challenges could arise because the proposed requirements are likely to cause charities to have ‘debt’ for the first time, which may either go against the charity’s constitution, and/or it may be viewed unfavourably by the charity’s stakeholders. (Respondent did not answer the specific questions in the Consultation Document)
R9	Nicol O’Donnell, Aviva (incorp. Christchurch Women's Refuge) Charitable Trust	NFP PBE preparer, Tier 2	Does not support the proposed new Standard	Considers that the proposed requirements are complex and that the costs would exceed the benefits for NFPs. (Respondent did not answer the specific questions in the Consultation Document)
R10	Anne Topham, Peak Chartered Accountants Limited	Accounting firm – clients include SMEs, NFPs, farms, Māori authorities and schools	Does not support the proposed new Standard for Tier 2 NFP and Tier 2 public sector PBEs	Considers that the proposed requirements are complex and that the costs would exceed the benefits. (Respondent did not answer the specific questions in the Consultation Document)
R11	Clare Randall, Arohanui Hospice	NFP Preparer, Tier 2	Does not support the proposed new Standard for NFPs	Considers that the proposed requirements are complex and that the costs would exceed the benefits. (Respondent did not answer the specific questions in the Consultation Document)

Appendix 2: Discussions with New Zealand stakeholders in March–May 2023

1. As noted above, respondents to ED PBE IPSAS 43 from the NFP sector expressed concerns regarding the proposals, noting that the proposed ROU model would be costly and complex to apply, and the cost would outweigh the benefit in the NFP sector.

2. In February 2023, staff proposed to temporarily exempt NFP PBEs from the ROU model and/or from PBE IPSAS 43. However, the majority of the Board did not prefer this option. Rather, the Board agreed that staff should explore practical expedients in relation to the ROU model – with a focus on NFP PBEs in the first instance, given that the concerns are coming from this sector.

3. Following the Board's decision, we have developed possible practical expedients relating to the ROU model. We discussed these possible practical expedients with the Accounting TRG and with those NFP stakeholders who responded to ED PBE IPSAS 43.

4. The main practical expedient that we proposed at the abovementioned discussions related to the <u>discount rate</u> used in determining the lease liability and ROU asset under the ROU model. Determining the discount rate was a common area of concern among NFP respondents to ED PBE IPSAS 43. We understand that this issue arises for the following reasons.

   (a) Under the proposed PBE IPSAS 43, it is expected that most lessees would use their '<u>incremental borrowing rate'</u> as the discount rate for calculating the lease liability and ROU asset. Consistently with IPSAS 43 and NZ IFRS 16, the lessee's incremental borrowing rate is a <u>lessee-specific, lease-term-specific and asset-specific rate</u>.

   (b) While the rate at which the lessee has borrowed from its bank is not necessarily the lessee's incremental borrowing rate (because the rate is also asset-specific), such a borrowing rate could be used as a starting point for calculating the incremental borrowing rate. However, from the ED feedback received, we understand that charities tend to not have borrowings, and therefore would not have a readily-available starting point for determining their incremental borrowing rate. They would have to obtain such a rate from a third party, which some respondents noted would be costly.

5. We therefore discussed with the TRG and NFP stakeholders the possibility of allowing NFP PBEs, or both public sector and NFP PBEs, to use a <u>specified published discount rate</u> (e.g. a risk-free rate corresponding to the lease term) in the calculation of the lease liability and ROU asset. We also discussed certain other practical expedients, as explained below.

6. This section summarises our discussions with the TRG and the NFP stakeholders. Please note that in both discussions, we made it clear to participants that the possible practical expedients we mentioned are staff suggestions and are yet to be discussed with the Board.

Discussion with the Accounting TRG

TRG comments on practical expedients in general

7. Comments from TRG Members regarding practical expedients in general included the following.

(a) TRG Members generally agreed that it is worth exploring New Zealand practical expedient(s) regarding the ROU model, especially expedients relating to the discount rate (see below), given the feedback received on ED PBE IPSAS 43 from NFP respondents.

(b) TRG Members preferred not to limit the practical expedients to the NFP sector only.

(c) Some TRG Members preferred limiting the availability of any New Zealand practical expedients to Tier 2 PBEs only. However, we note that the practical expedients would relate to recognition and measurement – and we understand that under the current New Zealand Accounting Standards Framework, we are not able to provide practical expedients relating to recognition and measurement to Tier 2 entities only. Furthermore, a TRG Member noted that if practical expedients were made available to Tier 2 PBEs only, such PBEs would struggle if and when they have to transition to Tier 1.

(d) A TRG Member noted that if we provide practical expedients relating to the ROU model for PBEs, for-profit entities (particularly those in Tier 2) may also request similar practical expedient. In a similar vein, some TRG Members were concerned that any differences between PBE IPSAS 43 and NZ IFRS 16 could cause confusion and could make reporting more challenging for mixed groups. Nevertheless, as noted above, TRG Members generally acknowledged that possible practical expedients for PBEs should be explored.

TRG comments on the suggested practical expedient relating to the discount rate

8. TRG Members noted the following regarding staff's proposed practical expedient that would expressly <u>allow lessees to use a specified published discount rate (e.g. the risk-free rate corresponding to the lease term) as their incremental borrowing rate</u>:

(a) TRG Members generally agreed that a practical expedient in relation to the discount rate is worth exploring.

(b) A TRG Member suggested considering a practical expedient that would allow an entity *not to discount lease payments at all* under the ROU model. He noted that deferred tax assets and liabilities are not discounted. Some TRG Members thought this option is worth exploring due to its simplicity, but others expressed nervousness regarding this option.

(c) Two TRG Members noted that a practical expedient allowing entities to discount using a *risk-free rate* as their incremental borrowing rate (as staff suggested) is better than allowing entities not to discount at all.

(d) In a similar vein, a TRG Member suggested that a *government bond rate* with a term corresponding to the lease term could be used as a proxy to the incremental borrowing rate.

(e) A TRG Member suggested that instead of allowing entities to use the risk-free rate as their incremental borrowing rate, the practical expedient could allow entities to use the *advertised business borrowing rate of one of the main banks*. He noted that even if this rate does not exactly match the lease term, using such a rate would be superior to using the risk-free rate, as the risk-free rate may be 'nowhere near' the rate at which a lessee could borrow.

(f) Another TRG Member suggested that there should be a *hierarchy of rates* that could be used as the incremental borrowing rate – similarly to the hierarchy of inputs into fair value measurement. The hierarchy could start from the lessee's specific bank borrowing rate (if available) and then the 'next level down' could be published commercial borrowing rates, then overdraft rates published by the RBNZ, etc. If it is not practical to determine the lessee-specific, asset-specific and term-specific incremental borrowing rate, the lessee would 'work their way down' the hierarchy and select a rate based on the information available to the lessee. A second TRG Members supported the idea of a hierarchy of rates, noting that if information is available to determine the incremental borrowing rate as described in ED PBE IPSAS 43 and NZ IFRS 16, then the lessee should use this information – but when this abovementioned information is not readily available or costly to obtain, the suggested hierarchy of rates would be useful.

(g) A TRG Member noted that if an entity finds it challenging to determine the incremental borrowing rate for one lease, e.g. because they do not have bank borrowings where they could use the borrowing rate as a starting point, then this challenge is likely to apply to all of the entity's leases. Therefore, it makes sense that a practical expedient relating to the discount rate would apply to *all leases*, when a lessee chooses to apply this expedient. However, another TRG Member thought the decision on what type of rate to use within the abovementioned hierarchy of rates should be made on a lease-by-lease basis.

(h) As an alternative option, a TRG Member suggested that instead of providing a discount-rate related practical expedient directly in the Standard, we could develop educational material on how the incremental borrowing rate can be determined. Given that the incremental borrowing rate is an estimate, such educational material could refer to the existing requirements and guidance in PBE Standards in relation to *accounting estimates* – and it could explain that for smaller PBEs applying the forthcoming PBE IPSAS 43, the level of precision and the 'quality' of the inputs into the estimate need not be as high as for, say a large listed company.

TRG comments on other possible practical expedients

9. Staff also sought TRG Members' views of the following possible practical expedients.

Table 1 Other possible practical expedients and exemptions

Possible expedient/exemption	TRG Members' comments
[1] Add another exemption from the ROU model – to exempt a subset of leases from the model (in addition to the existing exemptions for low-value leased assets and short-term leases). For example, we could exempt leases that are <u>not 'strategically significant'</u> to the entity from	TRG Members did not support this option, noting that: • if we provide an exemption for 'strategically significant' leases, it would be relatively easy for entities to argue that most/all of their leases are not strategically significant; and • providing an exemption for leases that do not relate to land/buildings would not be desirable, as there are some

Possible expedient/exemption	TRG Members' comments
the ROU model, or we could exempt <u>leases that do not relate to land/building</u>, etc.	assets other than land and buildings where application of the ROU model would result in useful and important information.
[2] Low-value leased asset exemption from the ROU model: Enhance the existing exemption by **expanding the list of examples of assets that are typically of 'low value'.** For example, we could include <u>photocopiers</u> and/or other assets not currently mentioned in the list of examples of low-value leased assets.	Some TRG Members supported providing additional examples of commonly-leased assets that would generally be considered 'low value' leased assets – except that these Members preferred this to be done via educational material/staff guidance, rather than within the Standard.
[3] Low-value leased asset exemption from the ROU model: Enhance the guidance relating to the existing exemption – by **introducing a monetary threshold** for 'low value' leased assets, and making that threshold **higher than the IASB's** threshold included in the Basis for Conclusions of IFRS 16.	Some TRG Members supported the idea of introducing a low-value leased asset threshold that would be higher than the threshold indicated by the IASB. However, other Members did not support this option – because it would represent a departure from international standards, and because a monetary threshold would need to be monitored and adjusted for inflation, etc.

10. TRG Members also made the following additional suggestions on how to address the concerns raised by the ED respondents from the NFP sector:

   (a) Charities Services could develop a tool for charities to assist in the application of the new lease accounting requirements under the forthcoming PBE IPSAS 43; and

   (b) A software company that sells lease accounting-related software could possibly offer charities access to a simplified version of the software for free or at a reduced price.

Roundtable discussion with NFP respondents to ED PBE IPSAS 43

Further refinements of the practical expedient relating to the discount rate

11. Following the discussion with the TRG, we considered how to refine our proposals relating to the discount rate, for the purpose of our roundtable discussion with the ED respondents from the NFP sector. Initially, we considered proposing a 'hierarchy' approach, as per the recommendation from one of the TRG Members – i.e. specify several a hierarchy of several types of published rates (see above). However, we ultimately considered that NFPs may find the 'hierarchy' approach to be complex.

12. Therefore, for the purpose of the roundtable discussion with the NFP ED respondents, we decided to suggest the same practical expedient that we suggested at the TRG discussion, i.e. a practical expedient would allow lessees to use a specified published discount rate (e.g. the risk-free rate corresponding to the lease term) as their incremental borrowing rate. At the roundtable, we referred to the discount rates published by the Treasury as an example of the specified discount rate that the practical expedient could refer to.

13. Nevertheless, we agreed with TRG Members that if it is feasible/practicable for an entity to use the entity-specific, lease-specific incremental borrowing rate as defined in draft PBE IPSAS 43 (and as aligned with IFRS 16), then the entity should do so.

14. Therefore, based on the above considerations, we suggested that the discount rate requirements in draft PBE IPSAS 43 could be amended as follows:

    (a) Currently, draft PBE IPSAS 43 requires lessees to use the interest rate implicit in the lease as the discount rate for calculating the lease liability, and if that rate is not readily determinable, then the lessee's incremental borrowing rate must be used.

    (b) We are considering the possibility of amending this requirement, by specifying that:

        (i) When the interest rate implicit in the lease is not readily determinable, then there is a *rebuttable presumption* that the lessee uses its incremental borrowing rate – but if the <u>lessee's incremental borrowing rate is impracticable to determine, then this presumption can be rebutted, in which case the lessee can use the risk-free rate commensurate with the lease term</u> to discount lease payments.

        (ii) To rebut the abovementioned presumption, the lessee would need <u>reasonable and supportable information</u> that it is impracticable to determine the incremental borrowing rate – e.g. if the lessee has <u>no material borrowings/debt.</u>

Comments from the NFP stakeholders

15. Our roundtable discussion was attended by most of the NFP stakeholders who responded to ED PBE IPSAS 43 – including Charities Services staff, staff of a Tier 2 NFP preparer, the director of an accounting firm providing services to small and medium NFPs – as well as an academic who published research on the impact that the ROU model would have on NFPs.

16. Charities Services staff and the academic participant were broadly supportive of our suggested practical expedient regarding the interest rate – noting that a published rate would be easily accessible without additional cost, and specifying a particular published rate that should be used (e.g. the Treasury's discount rates) would help ensure comparability. The academic participant suggested that 100 basis points should be added to the published discount rate.

17. However, the Tier 2 NFP preparers and the representative of the accounting firm catering for smaller NFPs continued to raise significant concerns regarding the ROU model. They did not think that our suggested practical expedient would help alleviate these concerns, particularly for Tier 2 NFP PBEs. They expressed the following views.

    (a) Instead of considering practical expedients from the ROU model, we should take a step back and consider an exemption from the ROU model for Tier 2 NFPs [Staff note: we understand that we are unable to provide recognition and measurement concessions to Tier 2 entities under the current New Zealand Accounting Standards Framework].

    (b) The Tier 2 threshold is too low – many of the charities that are in Tier 2 are too small to be required to apply a complex standard such as PBE IPSAS 43.

(c) It will be difficult to explain to those charged with the governance of an NFP and to users of NFPs' financial statements why leased buildings, leased vehicles, etc. are recognised on the balance sheet.

(d) Under the ROU model, the interest expense on the lease liability and the depreciation expense on the ROU asset do not match the lease payments – which 'muddies the waters' and could be confusing for those charged with an NFP's governance and for users of the financial statements.

(e) For NFPs, particularly those in Tier 2, applying the ROU model would result in no benefits for users of the financial statements – it will not help them understand the financial statements.

(f) Debt-to-equity and similar ratios are generally not as important to NFPs as they are to for-profit entities.

(g) If we allow PBEs to use a specified published discount rate only when it is 'not practicable' to use the incremental borrowing rate as defined in the Standard, entities will need to spend time and money on 'proving' that it is not practicable for them to determine the incremental borrowing rate.

(h) To avoid applying the ROU model, NFPs would renegotiate their lease agreements to make the lease term 12 months or less, so that the 'short-term lease' exemption from the ROU model would apply. However, lessors charge higher rentals for short-term leases, therefore NFPs will be facing higher leasing costs.

18. One of the participants who expressed the concerns above suggested that if the ROU model were to become mandatory for NFPs, then it should be restricted to leases that are above a certain quantum, e.g. X% of PP&E or of the entity's 'overall activities' – to ensure that ROU information is provided only where it is meaningful.

19. A participant also noted that the number of ED submissions/responses that we received from the NFP sector was not high. They thought it is possible that many NFPs have not engaged with the proposed Standard or do not understand it, which might be an issue.

Agenda Item 6.1

Memorandum

Date:	28 July 2023
To:	NZASB Members
From:	Jamie Cattell
Subject:	**Supplier Finance Arrangements RDR**

COVER SHEET

Project priority and complexity

Project priority	**Low** This is a narrow scope, disclosure-only amending standard which is likely to have limited applicability.
Complexity of Board decision-making at this meeting	**Medium** The Board is being asked to agree to issue an amending standard introducing RDR concessions. There is a clear analogy and basis for the staff recommendation and no modifications to any other requirements or wording is required.

Overview of agenda item

Project status	Draft amending Standard – We are seeking approval to consult on proposed Tier 2 RDR concessions for the disclosures introduced by *Supplier Finance Arrangements*.
Project purpose	To introduce Tier 2 RDR concessions for the new disclosures established by the for-profit amending Standard *Supplier Finance Arrangements.*
Board action required at this meeting	APPROVAL to consult on proposed RDR concessions for the disclosures introduced by *Supplier Finance Arrangements*.

Recommendations

1. The Board is asked to APPROVE for consultation the proposed Tier 2 RDR concessions outlined in the draft amending Standard *Supplier Finance Arrangements RDR* which amends NZ IAS 7 *Statement of Cash Flows*.

Background

2. At its meeting on 28 June 2023, the Board approved for issue the for-profit amending Standard *Supplier Finance Arrangements* (the amending standard) which amended NZ IAS 7 and NZ IFRS 7. At this time, in accordance with the requirements of EG A2 *Overview of the Accounting Standard-setting Process,* the Board agreed to develop an (ED) proposing new RDR concessions for the disclosures introduced by the amending standard.

Structure of this memo

3. The remaining sections in this memo are:
   (a) disclosure requirements in the amending standard;
   (b) proposed concessions; and
   (c) due process requirements.

Disclosure requirements in the amending standard

4. The amending standard amended disclosure requirements in NZ IFRS 7 by adding a new application guidance sub paragraph B11F(j). As this paragraph is already subject to an RDR concession in its entirety (as are the related disclosures in paragraph 39 of the NZ IFRS 7), no further amendment is needed. For this reason the amended paragraph has not been reproduced.

5. The amending standard established new disclosure requirements within NZ IAS 7 by adding paragraphs 44F and 44H. These paragraphs have been reproduced below for reference.

44F An entity shall disclose information about its supplier finance arrangements (as described in paragraph 44G) that enables users of financial statements to assess the effects of those arrangements on the entity's liabilities and cash flows and on the entity's exposure to liquidity risk.

…

44H To meet the objectives in paragraph 44F, an entity shall disclose in aggregate for its supplier finance arrangements:

(a) the terms and conditions of the arrangements (for example, extended payment terms and security or guarantees provided). However, an entity shall disclose separately the terms and conditions of arrangements that have dissimilar terms and conditions.

(b) as at the beginning and end of the reporting period:

(i) the carrying amounts, and associated line items presented in the entity's statement of financial position, of the financial liabilities that are part of a supplier finance arrangement.

(ii) the carrying amounts, and associated line items, of the financial liabilities disclosed under (i) for which suppliers have already received payment from the finance providers.

(iii) the range of payment due dates (for example, 30–40 days after the invoice date) for both the financial liabilities disclosed under (i) and comparable trade payables that are not part of a supplier finance arrangement. Comparable trade payables are, for example, trade payables of the entity within the same line of business or jurisdiction as the financial liabilities disclosed under (i). If ranges of payment due dates are wide, an entity shall disclose explanatory information about those ranges or disclose additional ranges (for example, stratified ranges).

(c) the type and effect of non-cash changes in the carrying amounts of the financial liabilities disclosed under (b)(i). Examples of non-cash changes include the effect of business combinations, exchange differences or other transactions that do not require the use of cash or cash equivalents (see paragraph 43).

6. In substance, the new disclosures required by the amending standard can be described as a combination of the:

   (a) changes in liabilities arising from financing activities disclosures in NZ IAS 7[1] - on the basis that the disclosures in the amending standard primarily relate to the effect of a financing arrangement on an entity's financial liabilities; and

   (b) quantitative liquidity risk disclosures in NZ IFRS 7[2] - on the basis that the disclosure objective includes liquidity risk and that the specific disclosures in paragraph 44H are analogous to the summary quantitative data and maturity analysis required by that standard.

7. We note that RDR concessions have already been provided in NZ IAS 7 and NZ IFRS 7 for all of these disclosures. The relevant paragraphs from NZ IAS 7 and NZ IFRS 7 have been included in Appendix A and Appendix B of this memo for the Board's reference.

Proposed concessions

8. At its June meeting, Board members suggested that RDR concessions could be provided for most of the disclosures introduced by the amending standard, but that disclosures related to the existence and the terms and conditions of supplier finance arrangements (reflected in paragraph 44H(a) may still be disclosed by Tier 2 entities. We therefore considered whether these disclosures can be isolated from other disclosures introduced by the amending standard without substantial amendment.

9. We do not consider that any of the disclosures in paragraph 44H can be separated from the other disclosures in that paragraph as they function collectively to achieve the disclosure objective set out in paragraph 44F. In other words, each individual disclosure in that paragraph 44H is necessary but not sufficient to achieve the objective. For example, the disclosure of the terms and conditions under paragraph 44H(a) alone could not reasonably be considered to provide sufficient information about the entity's exposure to liquidity risk.

10. Therefore in order to separate those disclosures, the disclosure objective in paragraph 44F would need to be amended. We do not recommend making these amendments at this time as it is beyond the scope of providing RDR concessions.

[1] These disclosures are found in paragraphs 44A – 44E of NZ IAS 7.

[2] These disclosures are found in paragraphs 34(a) and 39 of NZ IFRS 7

Staff recommendation

11. Overall our recommendation is that RDR concessions be provided for **all** new disclosures introduced by the amending standard for the following reasons.

    (a) Providing concessions for all disclosures would be consistent with the previous decisions by the Board that Tier 2 for-profit entities should not be required to comply with the:

        (i) disclosures related to changes in liabilities arising from financing transactions in NZ IAS 7; and

        (ii) quantitative liquidity risk disclosures in NZ IFRS 7.

    (b) The disclosures required by the amending standard cannot be individually required without making other substantive amendments to the requirements which would be beyond the scope of RDR considerations.

Questions for the Board
Q1. Does the Board agree with the Staff recommendation to provide RDR concessions for all disclosures introduced by the amending standard *Supplier Finance Arrangements?*

Due process requirements

12. Section 22 of the Financial Reporting Act 2013 outlines the requirements for consultation prior to the issuance of a standard, an authoritative notice, an amendment, or a revocation by the Board. It specifies that the Board must:

    (a) take reasonable steps to consult with individuals or representatives who would be substantially affected by the issuance; and

    (b) consult with the Privacy Commissioner before issuing a standard, an authoritative notice, or an amendment that could potentially require the disclosure of personal information.

13. This section also clarifies that any failure to comply with the consultation requirements does not invalidate the issued standard, notice, amendment, or revocation. Section 22 of the Act has been reproduced in Appendix C for reference.

14. At its June meeting, we advised the Board that our due process as set out in paragraph 23 of EG A2 *Overview of the Accounting Standard-setting Process,* required the NZASB to consult separately on proposed RDR concessions. While we consider that the Board would need to follow the full process if it intended to provide partial concessions for the new disclosures in *Supplier Finance Arrangements* we have since reconsidered this advice in the context of our recommendation to provide concessions for all new disclosures it establishes.

15. The purpose of EG A2 is to outline how the XRB ensures that it has met the requirements of section 22. As an explanatory document it has no legal status.

16. It does however clarify that the XRB expects the NZASB to consider the requirements of section 22(1). As per paragraph 65 of EG A2 it states that before approving a standard, authoritative notice, amendment or revocation for issue, the NZASB needs to satisfy itself that reasonable steps have been taken to consult with people or organisations likely to be affected.

17. Paragraph 23 of EG A2 outlines the due process by which the NZASB usually establishes RDR concessions. However, it does not preclude the issuance of any standard, amendment or revocation outside of this process provided that the NZASB is satisfied that it has met the requirements of paragraph 65 and by extension that the XRB has met the requirements of section 22(1).

18. If the Board agrees with our recommendation above to provide concessions for all new disclosures it establishes, we consider that minimal additional consultation is needed. Rather than produce a full suite of consultation documents, we intend to publish the proposals directly on the XRB website with a short comment period of 14 days. We consider this is appropriate for the following reasons.

    (a) The proposed disclosure concessions will cause *Supplier Finance Arrangements* to have no impact on tier 2 entities as it will revert their reporting obligations and accounting requirements to their state prior to issuing that amending standard. As the Act stipulates that consultation is necessary when the parties would be 'substantially affected', we consider that the minimal consultation described reflects the effect of the proposed concessions.

    (b) Due to the very narrow scope of the amending standard and the firm basis on which we can establish the concessions, it is unlikely that substantial further consultation will result in any new insights or changes to the concessions. It is important to ensure that we engage our stakeholders in meaningful and productive dialogue and in this case, we do not consider requiring them to read a full suite of consultation documents would be a valuable use of their time.

19. We therefore recommend that the board approve our proposed approach for consulting on the proposed RDR concessions.

20. While we do not intend to produce an exposure draft, a draft for-profit amending standard *Supplier Finance Arrangements RDR* is attached as agenda item 6.2.

Questions for the Board

Q2. Does the Board APPROVE our proposed approach for consulting on the RDR concessions outlined in the draft amending standard *Supplier Finance Arrangements RDR* which amends NZ IAS 7?

Attachments

Agenda item 6.2: Draft *Supplier Finance Arrangements - RDR*

Appendix A – Extracts from NZ IAS 7

Changes in liabilities arising from financing activities

***44A An entity shall provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.**

*44B To the extent necessary to satisfy the requirement in paragraph 44A, an entity shall disclose the following changes in liabilities arising from financing activities:

(a) changes from financing cash flows;

(b) changes arising from obtaining or losing control of subsidiaries or other businesses;

(c) the effect of changes in foreign exchange rates;

(d) changes in fair values; and

(e) other changes.

*44C Liabilities arising from financing activities are liabilities for which cash flows were, or future cash flows will be, classified in the statement of cash flows as cash flows from financing activities. In addition, the disclosure requirement in paragraph 44A also applies to changes in financial assets (for example, assets that hedge liabilities arising from financing activities) if cash flows from those financial assets were, or future cash flows will be, included in cash flows from financing activities.

*44D One way to fulfil the disclosure requirement in paragraph 44A is by providing a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities, including the changes identified in paragraph 44B. Where an entity discloses such a reconciliation, it shall provide sufficient information to enable users of the financial statements to link items included in the reconciliation to the statement of financial position and the statement of cash flows.

*44E If an entity provides the disclosure required by paragraph 44A in combination with disclosures of changes in other assets and liabilities, it shall disclose the changes in liabilities arising from financing activities separately from changes in those other assets and liabilities.

Appendix B – Extracts from NZ IFRS 7

Nature and extent of risks arising from financial instruments

…

Quantitative disclosures

*34 For each type of risk arising from financial instruments, an entity shall disclose:

(a) summary quantitative data about its exposure to that risk at the end of the reporting period. This disclosure shall be based on the information provided internally to key management personnel of the entity (as defined in NZ IAS 24 *Related Party Disclosures*), for example the entity's board of directors or chief executive officer.

(b) the disclosures required by paragraphs 35A–42, to the extent not provided in accordance with (a).

(c) concentrations of risk if not apparent from the disclosures made in accordance with (a) and (b).

…

Liquidity risk

*39 An entity shall disclose:

(a) a maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities.

(b) a maturity analysis for derivative financial liabilities. The maturity analysis shall include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows (see paragraph B11B).

(c) a description of how it manages the liquidity risk inherent in (a) and (b).

Appendix C – Section 22 of the Financial Reporting Act 2013

22 Consultation

(1) 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.

(2) The Board must not issue a standard, an authoritative notice, or an amendment that is likely to require the disclosure of personal information unless the Board has consulted the Privacy Commissioner.

(3) Any failure to comply with subsection (1) or (2) does not affect the validity of the standard, authoritative notice, amendment, or revocation.

(4) This section does not limit section 16 or 17 of the Crown Entities Act 2004.

Compare: 1993 No 106 s 26

Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Supplier Finance Arrangements RDR

Issued August 2023

Supplier Finance Arrangements RDR

Issued August 2023

This Tier 2 for-profit amending Standard introduces new disclosure concessions for Tier 2 for-profit entities in response to the new disclosures established by *Supplier Finance Arrangements* issued on 13 July 2023. This amending Standard modifies some of the requirements in NZ IAS 7 *Statement of Cash Flows*.

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

Legal status of amending Standard

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

This amending Standard is secondary legislation for the purposes of the Legislation Act 2019.

The amending Standard, pursuant to section 27(1) of the Financial Reporting Act 2013, takes effect on the 28th day after the date of its publication. The amending Standard was published under the Legislation Act 2019 on xx August 2023 and takes effect on xx September 2023.

Commencement and application

The amending Standard has a mandatory date of 1 January 2024, meaning it must be applied by Tier 2 for-profit entities for accounting periods that begin on or after this date.

Application to an earlier accounting period is permitted for accounting periods that end after this amending Standard takes effect – refer to paragraphs NZ 63.4 – NZ 63.7 of this amending Standard.

ISBN:xxxxxxxxxxxxx

CONTENTS

Part A – Introduction

This amending Standard amends the disclosure requirements in NZ IAS 7 *Statement of Cash Flows* introduced by *Supplier Finance Arrangements* issued on 13 July 2023 for Tier 2 for-profit entities.

Part B – Scope

This Standard applies to Tier 2 for-profit entities.

Part C – Amendments to NZ IAS 7 *Statement of Cash Flows*

Paragraphs 44F–44H are amended and paragraphs NZ 63.4–NZ 63.7 are added. New text is underlined except for paragraphs NZ 63.4–NZ 63.7 which have not been underlined for ease of reading.

Structure and content

…

Supplier finance arrangements

***44F An entity shall disclose information about its supplier finance arrangements (as described in paragraph 44G) that enables users of financial statements to assess the effects of those arrangements on the entity's liabilities and cash flows and on the entity's exposure to liquidity risk.**

*44G Supplier finance arrangements are characterised by one or more finance providers offering to pay amounts an entity owes its suppliers and the entity agreeing to pay according to the terms and conditions of the arrangements at the same date as, or a date later than, suppliers are paid. These arrangements provide the entity with extended payment terms, or the entity's suppliers with early payment terms, compared to the related invoice payment due date. Supplier finance arrangements are often referred to as supply chain finance, payables finance or reverse factoring arrangements. Arrangements that are solely credit enhancements for the entity (for example, financial guarantees including letters of credit used as guarantees) or instruments used by the entity to settle directly with a supplier the amounts owed (for example, credit cards) are not supplier finance arrangements.

*44H To meet the objectives in paragraph 44F, an entity shall disclose in aggregate for its supplier finance arrangements:

(a) the terms and conditions of the arrangements (for example, extended payment terms and security or guarantees provided). However, an entity shall disclose separately the terms and conditions of arrangements that have dissimilar terms and conditions.

(b) as at the beginning and end of the reporting period:

(i) the carrying amounts, and associated line items presented in the entity's statement of financial position, of the financial liabilities that are part of a supplier finance arrangement.

(ii) the carrying amounts, and associated line items, of the financial liabilities disclosed under (i) for which suppliers have already received payment from the finance providers.

(iii) the range of payment due dates (for example, 30–40 days after the invoice date) for both the financial liabilities disclosed under (i) and comparable trade payables that are not part of a supplier finance arrangement. Comparable trade payables are, for example, trade payables of the entity within the same line of business or jurisdiction as the financial liabilities disclosed under (i). If ranges of payment due dates are wide, an entity shall disclose explanatory information about those ranges or disclose additional ranges (for example, stratified ranges).

(c) the type and effect of non-cash changes in the carrying amounts of the financial liabilities disclosed under (b)(i). Examples of non-cash changes include the effect of business combinations, exchange differences or other transactions that do not require the use of cash or cash equivalents (see paragraph 43).

...

Commencement and application

...

NZ 63.4 The amending Standard *Supplier Finance Arrangements RDR*, published in August 2023, amended paragraphs 44F - 44H. An entity shall apply those amendments in accordance with the commencement and application date provisions in paragraphs NZ 63.5–NZ 63.7. An entity that applies those amendments to an 'early adoption accounting period' shall disclose that fact.

When amending Standard takes effect (section 27 Financial Reporting Act 2013)

NZ 63.5 The amending Standard takes effect on the 28th day after the date of its publication under the Legislation Act 2019. The amending Standard was published on xx August 2023 and takes effect on xx September 2023.

Accounting period in relation to which standards commence to apply (section 28 Financial Reporting Act)

NZ 63.6 The accounting periods in relation to which this amending Standard commences to apply are:

(a) for an **early adopter**, those accounting periods following and including, the **early adoption accounting period**.

(b) for any other reporting entity, those accounting periods following, and including, the first accounting period for the entity that begins on or after the **mandatory date.**

NZ 63.7 In paragraph NZ 63.6:

early adopter means a reporting entity that applies this amending Standard for an early adoption accounting period

early adoption accounting period means an accounting period of the early adopter:

(a) that begins before the mandatory date but has not ended or does not end before this amending Standard takes effect (and to avoid doubt, that period may have begun before this amending Standard takes effect); and

(b) for which the early adopter:

(i) first applies this amending Standard in preparing its financial statements; and

(ii) discloses in its financial statements for that accounting period that this amending Standard has been applied for that period.

mandatory date means 1 January 2024.

Date:	28 July 2023
To:	NZASB Members
From:	Leana van Heerden and Anthony Heffernan
Subject:	**IPSAS 47 Revenue: Project Plan**

COVER SHEET

Project priority and complexity

Project priority	**High**
Complexity of Board decision-making at this meeting	**High** We are seeking Board FEEDBACK on the draft Project Plan, which includes the key focus areas for developing a PBE Standard using IPSAS 47 *Revenue*. We are also seeking Board FEEDBACK on the approach for drafting the PBE ED to improve the understandability and accessibility of the proposed standard.

Overview of agenda item

Project status	The Board at its last meeting agreed to commence a project to develop a PBE standard using IPSAS 47 as its starting point. At this meeting we are seeking Board FEEDBACK on the draft Project Plan including the key issues that will be considered during the development of the PBE exposure draft (ED). Our initial focus areas will be to address concerns raised by the Board regarding the recognition of a liability and/or asset when applying the requirements of IPSAS 47 and IPSAS 48 *Transfer Expenses* in contrast to the definitions in the IPSAS Conceptual Framework.
Project purpose	To develop an improved revenue standard for Tier 1 and Tier 2 PBEs. Based on significant concerns previously raised by constituents about the existing revenue standards, we feel there is a strong argument that a new PBE standard on revenue using IPSAS 47 as a starting point will lead to improved financial reporting. Amendments to IPSAS 47 will be considered to ensure that any new PBE Standard on Revenue is fit-for-purpose in New Zealand – with a focus on robustness of key principles, understandability, and accessibility.
Board action required at this meeting	1. Provide FEEDBACK on the draft Project Plan. 2. Provide preliminary FEEDBACK on the extent to which staff should consider modifications to improve understandability and accessibility.

Introduction[1]

1. The International Public Sector Accounting Standards Board (IPSASB) approved IPSAS 47 *Revenue* at its March 2023 meeting. IPSAS 47 was published on 26 May 2023.

2. The purpose of the *Revenue* project was to develop a new revenue standard that provides recognition and measurement requirements for public sector revenue transactions, and addresses application issues with the existing suite of revenue IPSAS. A key objective of the project was also to achieve alignment with IFRS 15 *Revenue from Contracts with Customers* to the extent appropriate for the public sector.[2]

3. IPSAS 47 replaces the following IPSAS Standards on Revenue:

   (a) IPSAS 9 *Revenue from Exchange Transactions*;

   (b) IPSAS 11 *Construction Contracts*; and

   (c) IPSAS 23 *Revenue from Non-Exchange Transactions* (Taxes and Transfers)

4. The *Policy Approach to Developing the Suite of PBE Standards* (PBE Policy Approach) was considered during the June 2023 NZASB meeting. The Board agreed to commence a project to develop a new PBE Standard on *Revenue* using IPSAS 47 as its starting point.

5. Appendix 1 of this memo includes the draft Project Plan which highlights the key issues for consideration during the development of the PBE ED and the project timeline.

Draft Project Plan

6. The draft Project Plan is provided in Appendix 1.

7. The Project Plan has been developed as a stand-alone-document that can be used for future reference by the Board and externally by anyone following this important project.

Question for the Board

Q1. Does the Board have any FEEDBACK on the draft Project Plan for the PBE Revenue project?

In particular, we welcome Board feedback on:

(a) the key issues as documented in the Project Plan;

(b) any other issues that should be considered by staff as identified from your review of IPSAS 47 (supporting papers — 8.1A: IPSAS 47 *Revenue*); and

(c) any other areas identified for improvement when developing a PBE ED using IPSAS 47.

[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 IPSASB has a policy of IFRS alignment and amending IASB based standards to address public sector specific issues.

Development of draft PBE ED – modifications to improve understandability and accessibility

8. Recently we have received increased calls for the understandability and accessibility of PBE Standards as issued by the XRB to be improved, largely from smaller NFP Tier 2 entities.

9. We are interested in the Board's view on the extent of modifications to IPSAS 47 that should be considered when seeking to improve the understandability and accessibility of the PBE standard across both the public and NFP sectors in New Zealand.

10. We will consider separately as part of future issues discussions, whether the revenue recognition principles in IPSAS 47 are consistent with PBE Conceptual Framework (which is aligned with the IPSASB's Conceptual Framework) and whether there is appropriate guidance to support the consistent application of definitions, principles, and core requirements.

11. Historically we have not significantly modified an IPSAS, when developing a PBE standard, to improve its understandability and accessibility. Instead, modifications have mainly been limited to removing options not applicable to New Zealand and adding guidance to assist NFP entities in applying the requirements. We have also made changes in the past where we considered the principles in an IPSAS have not been applied consistently across the application guidance and illustrative examples.

12. A focus on modifications to improve the understandability and accessibility of the PBE standard using IPSAS 47 would involve staff considering changes to the structure, order of paragraphs, bringing forward application guidance, and considering simplifications to the language used in IPSAS 47 [3]. Changes of this nature provide for an increased risk of modifications reflected in the PBE standard changing the intended meaning, outcome, or interpretation when contrasted to IPSAS 47.

13. The New Zealand Accounting Standards Framework provides scope for modifying an IPSAS when developing a PBE standard.
    (a) The Framework uses IPSAS as the starting point for developing PBE Standards.
    (b) PBE Standards modify IPSAS for any recognition, measurement or disclosure matters considered inappropriate in New Zealand. Such modifications are only made where the IPSAS requirement in question has a material impact on the financial position or performance being reported, and that impact would adversely detract from the financial statements' usefulness to users.
    (c) The PBE Standards are also modified to make them relevant, applicable, and understandable to the not-for-profit sector preparers and users. Some modification is desirable to enhance their usefulness in the not-for-profit context.

14. The PBE Policy Approach provides examples of possible modifications to an IPSAS when developing a PBE equivalent standard, including:
    (a) amendments to improve the quality and consistent application of the IPSAS in the New Zealand context by, for example, adding guidance or making changes to enhance the clarity and consistency of the requirements;

(b) adding guidance to assist NFP PBEs in applying the standard, given that the standard has been developed for application by public sector PBEs;

(c) amending as necessary to maintain the coherence of the suite of PBE Standards;

(d) excluding options that are not relevant in the New Zealand context; and

(e) amending the scope of an IPSAS if the IPSAS conflicts with a legislative requirement, or a legislative requirement addresses the same issue for public sector entities.

Staff view

15. Amendments to IPSAS 47 to improve the understandability and accessibility of a New Zealand PBE version should be considered. This may include substantive changes to the structure and ordering of paragraphs in the standard including the location of guidance between the core standard, the application guidance, implementation guidance, and illustrative examples.

16. This view is based on the understanding that IPSAS 47 has been predominantly developed with public sector entities (including Governments) in mind and the PBE standard needs to be fit-for-purpose for a broader user group in New Zealand. This view is also influenced by initial feedback received from several individuals that IPSAS 47 is very difficult to understand and follow.

17. Staff note the risks that arise when making any form of substantive amendments to an international standard. This risk exists even when only changing the ordering of core requirements and guidance (and not changing any words). It is important that any amendments, to improve understandability and accessibility, do not change the underlying meaning or interpretation of the requirements in the IPSAS. In considering any amendments in response to understandability and accessibility concerns we will remain conscious of the risk.

Question for the Board

Q1. Does the Board have any views on the extent to which staff should consider modifications to improve the understandability and accessibility of a PBE standard on Revenue using IPSAS 47?

Q2. Are your views on the drafting approach the same for the development of a new PBE standard for *Transfer Expenses* using IPSAS 48 as a starting point (discussed in Agenda Item 8.2)?

Next steps

18. We will revise the project plan in line with the Board's feedback and present our first paper on the key issues at the Board's October 2023 meeting.

Attachments:

8.1A: IPSAS 47 *Revenue* (Full Standard)

8.1B: IPSAS 47 *Revenue* (At a Glance)

[3] Including definitions and other terminology that may not be immediately initiative for the reader of the standard.

Appendix 1 – draft Project Plan

Development of a PBE ED using IPSAS 47 *Revenue*

Project objectives

1. This project aims to develop a new PBE *Revenue* standard that provides recognition and measurement requirements for revenue transactions, using IPSAS 47 *Revenue* issued by the IPSASB, and is fit for purpose in New Zealand.

2. Revenue serves as a key financial performance measure for public benefit entities (PBEs), playing a significant role in determining the nature and volume of its service delivery activities. The amount of revenue recognised in the year provides a critical insight into an entity's financial wellbeing and its ability to continue operating. The question of when inflows of resources should be recognised as revenue has a direct impact on any entity's net financial performance for the reporting period. Having clear principles, guidance, and requirements concerning the accounting for revenue that support consistent and transparent reporting is therefore seen as highly relevant and important for PBEs.

3. This project aims (using IPSAS 47 as its starting point) to:

   (a) provide a robust and improved framework for the recognition of the different types of revenue transactions that arise across the public and not-for-profit sectors in New Zealand;

   (b) addresses issues raised by constituents when applying the existing PBE Standard on revenue; and

   (c) achieve alignment with IFRS 15 *Revenue from Contracts with Customers* to the extent appropriate for the public sector.

Key deliverables

4. The issuance of a new PBE Standard on *Revenue* standard, in accordance with the project timeline, to replace:

   (a) IPSAS 9 *Revenue from Exchange Transactions*;

   (b) IPSAS 11 *Construction Contracts*; and

   (c) IPSAS 23 *Revenue from Non-Exchange Transactions* (Taxes and Transfers)

Consistency with XRB's strategic objectives

5. In fulfilling its core function of issuing financial reporting standards, the XRB has an overriding objective of establishing a suite of accounting standards that engender trust and confidence in New Zealand's external reporting. This is achieved by maintaining accounting standards that encourage high-quality, meaningful, and well-accepted financial reports which are internationally recognised, and address New Zealand user needs.

6. Development of a PBE Revenue Standard, using IPSAS 47 as a starting point will result in higher quality financial reporting by the PBE sectors and meet the needs of stakeholders as it:
   (a) creates international alignment with IPSASB Standards as well as IFRS 15 to the extent appropriate for the public sector;
   (b) addresses existing application challenges in the current PBE suit of revenue standards;
   (c) is highly relevant to public sector and not-for-profit entity financial reporting; and
   (d) creates coherence with the existing suite of PBE Standards.
7. Based on this it is expected that the benefits will outweigh the costs and a draft standard for consultation should be developed.

Project scope

8. The project scope includes establishing new accounting requirements for all revenue transactions (except those excluded below) as applied by Tier 1 and Tier 2 PBEs (Public Sector and Not-for-Profit entities) in New Zealand.
9. The project scope excludes (as per IPSAS 47):
   (a) Contributions to social benefit schemes that are accounted for in accordance with an insurance approach;
   (b) A public sector combination within the scope of PBE IPSAS 40 *Public Sector Combinations*;
   (c) The accounting for contributions from owners in their capacity as owners;
   (d) Lease contracts within the scope of PBE IPSAS 13 Leases;
   (e) Insurance contracts within the scope of PBE IFRS 17 *Insurance Contracts*;
   (f) Financial instruments and other contractual rights or obligations within the scope of PBE IPSAS 41 *Financial Instruments*;
   (g) Rights or obligations arising from binding arrangements within the scope of PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*, PBE IPSAS 32 *Service Concession Arrangements: Grantor*, PBE IPSAS 34 *Separate Financial Statements*, PBE IPSAS 35 *Consolidated Financial Statements*, PBE IPSAS 36 *Investments in Associates and Joint Ventures*, PBE IPSAS 37 *Joint Arrangements*, PBE IPSAS 39 *Employee Benefits*, and PBE IPSAS 40;
   (h) Non-monetary exchanges between entities in the same line of business to facilitate sales to resource providers or potential resource providers. For example, this Standard would not apply to a binding arrangement between two public sector entities that agree to an exchange of electricity to satisfy demand from their resource providers in different specified locations on a timely basis;
   (i) Gains from the sale of non-financial assets that are not an output of an entity's activities and are within the scope of PBE IPSAS 16 *Investment Property*, PBE IPSAS 17 *Property, Plant, and Equipment*, or PBE IPSAS 31 *Intangible Assets*;

(j) Changes in the value of current and non-current assets arising from subsequent measurement;

(k) Initial recognition or changes in the fair value of biological assets related to agricultural activity; and

(l) The extraction of mineral resources.

Key issues

10. As part of the process of developing a PBE ED on Revenue is the NZASB consideration of any New Zealand-specific issues, areas where additional guidance is required (especially for application by NFPs), and any other areas for improvement to ensure the standard is fit-for-purpose for preparers and will meet PBE user-needs.

11. Based on feedback received from New Zealand constituents (and review of NZASB submissions) in responses to IPSASB consultations on revenue, recent discussions with representatives from the PBE sector[4], and staff analysis of IPSAS 47 — we have identified the following key issues for consideration when developing a PBE standard using IPSAS 47 as a starting point.

Table 1: Key issues

Topic	Issue
#1: Main principles	IPSAS 47 introduces new revenue recognition principles that may create complexities and confusion upon implementation. These principles include: • Binding arrangement - an arrangement that confers both rights and obligations, enforceable through legal or equivalent means, on the parties to the arrangement; • Enforceability - can arise from various mechanisms, so long as the mechanism(s) provide(s) the entity with the ability to enforce the terms of the binding arrangement and hold the parties accountable for the satisfaction of their obligations; and • Compliance obligation - an entity's promise in a binding arrangement to either use resources internally for distinct goods or services or transfer distinct goods or services to a purchaser or third-party beneficiary. XRB staff will explore whether these principles and the related guidance are sufficiently clear, concise, and fit for purpose within the New Zealand PBE context.

4 We meet with PBE sector representatives on 23 June to discuss current issues with the existing PBE Standards on Revenue. Attendance included representatives from Treasury, OAG, Audit NZ, Wellington City Council, Auckland City Council, and a practitioner with NFP reporting experience.

<table>
<tr><th>Topic</th><th>Issue</th></tr>
<tr><td>#2: Consistency of revenue recognition principles in IPSAS 47 with conceptual framework definitions of liability and asset</td><td>
The NZASB considered the Conceptual Framework definition of liabilities in contrast to the revenue recognition requirements and principles as proposed in IPSAS ED 70 Revenue with Performance Obligations and ED 71 Revenue without Performance Obligations. In the NZASB comment letter to the IPSASB in October 2020, the following was raised:
From a conceptual perspective we disagree with the IPSASB's conclusion that, in the absence of a performance obligation [being an obligation to transfer distinct goods or services to a third party], an entity's obligations arising from binding arrangements [other types of present obligations to act or perform in a certain way] represent an outflow of resources as discussed in the Conceptual Framework. We are also concerned about the implications of the proposals in ED 71 for the existing understanding of when liabilities should be recognised.
IPSAS 47 seeks to address this concern by introducing the concept of a "compliance obligation" which is broader than the IFRS 15 concept of a "performance obligation".
A compliance obligation in IPSAS 47 is an entity's promise in a binding arrangement (as a result of a revenue transaction] to use resources:
(a) internally to acquire distinct goods or services to enable it to advance its service delivery objectives;
(b) to transfer distinct goods or services to the resource provider; or
(c) to transfer distinct goods or services to third-party beneficiaries.
XRB staff will assess the recognition of a liability by unpacking the different categories of revenue transactions to highlight under which scenarios the complexities remain. In consultation with the Board, we will consider to what extent we are willing/unwilling to possibly "stretch" the Conceptual Framework liability definition when applying the requirements of IPSAS 47. This will be performed in conjunction with the Conceptual Framework asset definition and similarly assessing this with the requirements of IPSAS 48 Transfer Expenses.
</td></tr>
</table>

Topic	**Issue**
#3: Allocation of the transaction price	New Zealand constituent comment letters raised concerns that the allocation of the transaction price to different compliance obligations is complex and difficult to apply in practice. It was also noted in the public sector there is often no reference in the market to determine the transaction price of specific services (especially when provided under non-exchange terms). We note the guidance in IPSAS 47 around the allocation of the transaction price between different compliance obligations remained largely consistent with the ED proposals. XRB staff will consider the sufficiency of the guidance in light of the new concept of revenue with/without binding arrangements and compliance obligations. Furthermore, we will also consider whether additional guidance is required in New Zealand to assist entities in applying the materiality concept over different components of the revenue transaction.
#4: Capital transfers	New Zealand constituent comment letters raised concerns that the accounting for capital grants/transfers required clarity about when revenue should be recognised under different circumstances. In response to ED comments received, the IPSASB: • included a definition for capital transfers as *an inflow of cash or another asset that arises from a binding arrangement with a specification that the entity acquires or constructs a non-financial asset that will be controlled by the entity*. • added Application Guidance where it is concluded that the accounting principles in the binding arrangement model are appropriate for capital transfers and that revenue should be recognised as the compliance obligation to acquire or construct the non-financial asset is satisfied. • revised and enhanced the illustrative examples to help illustrate the application of the accounting principles using general fact patterns prevalent globally among public sector entities. XRB staff will consider whether the guidance is sufficient to ensure the consistent application of capital transfer requirements in New Zealand. This will include considering if an additional illustrative example is needed for the common New Zealand scenario whereby capital funding is provided in tranches after milestones are achieved.

Topic	Issue
#5: Multi-year funding arrangements and grants with time-based requirements	OAG (and others) recommended in response to the IPSAS ED, that application guidance and illustrative examples are needed on when assets and revenue should be recognised in transactions that involve multi-year funding arrangements, and where funding is provided only on the condition that it be used over a specified time period. Per IPSAS 47 Implementation Guidance provides that the core accounting principles within the standard do not differ for multi-year grants/long-term contracts. An entity will still need to consider whether the arrangement is a binding arrangement, and then apply the appropriate accounting model. The additional "complexity" that comes from multi-year arrangements lies in the timing differences between when funding is received and whether that funding is required to be recognised as revenue immediately. The accounting principles in each model address this, by prompting the entity to consider whether the inflow (or right to an inflow) of resources meets the definition of an asset, and if there are any associated enforceable obligations that meet the definition of a liability (which would defer revenue recognition). XRB staff will consider whether the guidance provided is sufficient and if additional illustrative examples are needed to support consistent application by PBEs.
#6: Disclosures	New Zealand constituents commented that the disclosure requirements were excessive and didn't have sufficient structure to distinguish between general requirements and requirements related to revenue with/without present obligations. The IPSASB responded by presenting revenue guidance in a single standard and with a revised order to partially address constituent comments. In addition, the overall volume of disclosures has been reduced. XRB staff will consider whether disclosure requirements are appropriate in the New Zealand context. The NZASB will also consider RDR concessions for Tier 2 entities.

Other key project development considerations

12. In addition to the key issues above, we note the following key matters that will require consideration during the development of the PBE ED on Revenue.

Consistency of revenue recognition principles in IPSAS 47 with the Conceptual Framework

13. The initial focus of the project will be on seeking NZASB conclusions in response to Issue #1 and Issue #2 noted above. The NZASB has previously raised concerns regarding the core revenue recognition principles in IPSAS 47 regarding the recognition of revenue arising from a

binding arrangement without "performance obligations" (as defined by IFRS 15) and whether this gives rise to a liability (as defined by the conceptual framework) for any unfulfilled enforceable "compliance obligations" at the reporting date.

14. This principle underpins the entire IPSAS 47 revenue recognition approach. The outcome of these Board deliberations may require this Project Plan to be revisited and revised.

Post-implementation review of IFRS 15

15. IPSAS 47 introduces new requirements and guidance to achieve alignment with IFRS 15 to the extent appropriate for the public sector. We note the IASB issued a Request for Information to support a post-implementation review (PIR) of IFRS 15 in June 2023 (with the comment period closing on 27 October 2023).

16. We will consider the feedback received in response to the PIR of IFRS 15 where it helps <u>inform</u> NZASB deliberations on the key issues discussed above and to help identify where additional guidance may be useful for PBEs. However, in accordance with the *PBE Policy Approach,* we will generally wait for the IASB to finalise any amendments to IFRS 15 (and then for those amendments to be considered by the IPSASB) before seeking to incorporate them into our PBE Standards.

Interaction with Transfer Expenses Project

17. IPSAS 47 is aligned with IPSAS 48 *Transfer Expenses* with respect to the concept of a "binding arrangement", which is fundamental to the accounting for both revenue and transfer expenses under IPSAS.

18. Staff are working collaboratively to ensure IPSAS 47 and IPSAS 48 will be developed for adoption into the PBE suite of Standards at the same time, and that the principles and requirements in IPSAS 47 and IPSAS 48 are consistent to the extent appropriate when considering the resource provider (accounting for expenditure) and resource recipient (accounting for revenue) perspective. Refer to agenda item 8.2 for the Project Plan relating to IPSAS 48.

Project timeline

19. A summary of the indicative project timeline is provided in Figure 1 below.

Figure 1

20. Table 2 provides further detail of the actions planned throughout the development of the PBE Standard. It also sets out our initial thoughts on recommended outreach activities for the ED (which will be supported by a full Communication Plan developed closer to the time).

Table 2: Detail of estimated timeline for development of PBE IPSAS 47 *Revenue*

Date (estimated)	Project activity
May 2023	IPSASB issued IPSAS 47 *Revenue*
June 2023	NZASB applied the PBE Policy Approach and agreed in principle to go ahead with the project with an initial focus to address the concerns raised by the Board regarding the recognition of a liability and/or asset when applying the requirements of IPSAS 47 *Revenue* and IPSAS 48 *Transfer Expenses* in contrast to the definitions in the IPSAS Conceptual Framework, refer to focus areas below.
August 2023	10 August NZASB Meeting Staff seek NZASB feedback on the project plan to develop a new PBE Standard using IPSAS 47 Revenue as a starting point; and Staff seek feedback from NZASB on preliminary views on the focus areas for development of the new PBE Standard.

Date (estimated)	Project activity
Discussion of issues (two NZASB meetings)	
Sep-Dec 2023	Staff performs analysis on focus areas to present conclusions at October 2023 and December 2023 NZASB meetings. The proposed coverage of the focus areas, at the respective meetings, are as follows: 19 October 2023 NZASB Meeting • To ensure appropriate guidance is provided (for NZ PBE Standard) concerning key definitions that underpin the revenue recognition principles — “binding arrangement”, “enforceability” and “compliance obligation”; and • To ensure the Board is comfortable that the recognition of a liability (deferral of revenue recognition) and/or asset when applying the requirements of IPSAS 47 *Revenue* and IPSAS 48 *Transfer Expenses* for different classes of transactions is consistent with the definitions and recognition criteria in the XRB’s PBE Conceptual Framework. 13 December 2023 NZASB Meeting Discussion of other issues identified by staff or raised in NZASB comment letter on EDs. • Allocation of the transaction price between different compliance obligations with specific timing and/or conditions attached to it; • Capital transfers and multi-year funding arrangements; and • Other issues raised by NZ constituents during the IPSASB ED stage
Development and approval of PBE ED (two NZASB Meetings)	
Jan - Mar 2024	Drafting of the ED and Consultation Paper. A prominent criticism of ED 70, ED 71, and IPSAS 47 is the length and complexities contained within these Standards. This drafting process will involve consideration of whether improvements are required to support understandability and accessibility. It will also be considered whether the illustrative examples are sufficient in the New Zealand context. We expect that this process will be performed with support from a sub-board of the NZASB. Furthermore, during this phase staff will also check in with PBE sector representatives to ensure we captured all key issues.
Mar 2024	28 March 2024 NZASB Meeting Working draft of the ED and Consultation Document considered by NZASB.
May 2024	9 May 2024 NZASB Meeting NZASB to approve ED PBE IPSAS 47 Revenue and Consultation Document for publication

Date (estimated)	Project activity
PBE ED on Revenue open for consultation (4 months)	
May-Aug 2024	Staff undertakes targeted and broad-scope outreach activities which will include: • Notification to constituents about the EDs via an NZASB Update. • Promote awareness of, and seek feedback on, the proposals at the Public Sector Advisory Group. • Roundtable discussions with representatives from the public sector and not-for-profit (NFP) sector. • Liaise with Charities Services staff about promoting awareness via the Charities Services' newsletter and website. • Host webinars to explain the Standard and raise awareness of the changes. • Promote awareness of the proposals at relevant conferences and events occurring during this time. • In addition, we will contact New Zealand respondents who commented on the IPSASB consultation papers and EDs.
Analysis of feedback and development of PBE IPSAS (two meetings)	
Sep 2024	Staff analyse feedback received on the ED.
Oct 2024	15 October 2024 NZASB Meeting NZASB to consider staff's analysis of feedback received on ED PBE IPSAS 47 *Revenue.*
Dec 2024	4 December 2024 NZASB Meeting NZASB to consider staff's recommended changes in response to ED feedback.
Feb 2025	NZASB to approve the final draft of PBE IPSAS 47.
Mar 2025	PBE IPSAS 47 is issued and becomes effective for periods beginning on or after 1 July 2027.

Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Memorandum

Date:	28 July 2023
To:	NZASB Members
From:	Carly Berry
Subject:	**PBE Transfer Expenses: project plan**

COVER SHEET

Project priority and complexity

Project priority	**High**
Complexity of Board decision-making at this meeting	**Medium** We are seeking Board FEEDBACK on the draft Project Plan, which includes the key focus areas for developing a PBE Standard using IPSAS 48 *Transfer Expenses* as a starting point.

Overview of agenda item

Project status	The Board at its last meeting agreed to commence a project to develop a PBE standard using IPSAS 48 as its starting point. At this meeting we are seeking Board FEEDBACK on the draft Project Plan, including the key issues that will be considered during the development of the PBE exposure draft (ED).
Project purpose	The purpose of this project is to develop a new PBE Standard for *Transfer Expenses* using IPSAS 48 as a starting point, while also ensuring that the standard is fit-for-purpose in New Zealand – with a focus on the robustness of key principles, understandability, and accessibility.
Board action required at this meeting	PROVIDE FEEDBACK on the draft Project Plan.

Introduction[1]

1. The International Public Sector Accounting Standards Board (IPSASB) published IPSAS 48 *Transfer Expenses* on 26 May 2023. At its June 2023 meeting, the Board:

    (a) applied the *Policy Approach to Developing the Suite of PBE Standards* (PBE Policy Approach) to IPSAS 48 and agreed to commence a project to develop a PBE Standard, using IPSAS 48 as a starting point ("PBE IPSAS 48"); and

    (b) provided feedback on the preliminary focus areas as recommended by staff, as well as suggested other focus areas.

2. Appendix 1 of this memo includes the draft Project Plan which highlights the key issues for consideration during the development of the PBE ED and the project timeline. The Project Plans and timelines for both PBE IPSAS 47 *Revenue* and PBE IPSAS 48 are largely aligned, due to the need to maintain coherence between these two standards.

Draft Project Plan

3. The draft Project Plan is provided in Appendix 1. The Project Plan has been developed as a stand-alone document that can be used for future reference by the Board and externally by anyone following this important project.

Question for the Board

Q1. Does the Board have any FEEDBACK on the draft Project Plan for PBE *Transfer Expenses*?

In particular, we welcome Board feedback on:

(a) the key issues as documented in the Project Plan;

(b) any other issues that should be considered by staff as identified from your review of IPSAS 48 (supporting papers — 8.2A: IPSAS 48 *Transfer Expenses*); and

(c) any other areas identified for improvement (from a general drafting perspective) when developing a PBE ED using IPSAS 48 as a starting point.

Next steps

4. We will revise the project plan in line with the Board's feedback and present our first paper on the key issues at the Board's October 2023 meeting.

Attachments:

8.2A: IPSAS 48 *Transfer Expenses* (Full Standard)

8.2B: IPSAS 48 *Transfer Expenses* (At a Glance)

[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).

Appendix 1 – draft Project Plan

Development of a PBE ED using IPSAS 48 *Transfer Expenses* as a starting point

Project objectives

1. This project aims to develop a new PBE Transfer Expenses Standard that provides recognition and measurement requirements for transfer expense transactions using IPSAS 48 *Transfer Expenses* as a starting point, and is fit for purpose in New Zealand.

2. Transfer expenses account for a significant portion of expenditures for many public sector and not-for-profit entities. This new standard will fill a significant gap in the PBE suite of standards by providing guidance to help entities account for the transfer of goods or services as part of meeting its public sector or not-for-profit service delivery objectives.

3. The project considers the reporting from a resource provider perspective and addresses the key question of when an outflow of resources should be recognised as an expense. The recognition of transfer expenditure has a direct impact on an entity's net financial performance for the reporting period. Having clear principles, guidance, and requirements concerning the accounting for transfer expenses that support consistent and transparent reporting is therefore seen as highly relevant and important for PBEs.

4. This project aims (using IPSAS 48 as its starting point) to:

   (a) provide a robust framework for the recognition of the different types of transfer expense transactions that arise across the public and not-for-profit sectors in New Zealand; and

   (b) address issues raised by constituents when accounting for transfer expenses in practice (due to the current lack of specific accounting requirements).

Key deliverables

5. The issuance of a new PBE Standard for transfer expenses, in accordance with the project timeline.

Consistency with XRB's strategic objectives

6. In fulfilling its core function of issuing financial reporting standards, the XRB has an overriding objective of establishing a suite of accounting standards that engender trust and confidence in New Zealand's external reporting. This is achieved by maintaining accounting standards that encourage high-quality, meaningful, and well-accepted financial reports which are internationally recognised, and address New Zealand user needs.

7. Development of a PBE Standard for transfer expenses, using IPSAS 48 as a starting point will result in higher quality financial reporting by the PBE sectors and meet the needs of constituents as it:

   (a) creates international alignment with IPSASB Standards;

   (b) addresses existing application challenges in practice;

   (c) is highly relevant to public sector and not-for-profit entity financial reporting; and

(d) creates coherence with the existing suite of PBE Standards.

8. Based on this it is expected that the benefits will outweigh the costs and a draft standard for consultation should be developed.

Project scope

9. The project scope includes establishing new accounting requirements for all transfer expenses (as defined and except those excluded below) as applied by Tier 1 and Tier 2 PBEs (public sector and not-for-profit entities) in New Zealand.

10. Transfer expense is currently defined by IPSAS 48 as:

    An expense arising from a transaction, other than taxes, in which an entity provides a good, service or other asset to another entity (which may be an individual) without directly receiving any good, service or other asset in return.

    Examples of transfer expenses include donations and grants from a transfer provider perspective, either involving the transfer of cash or other assets to an external party.

11. Using IPSAS 48 as a starting point, the project scope excludes expense transactions arising from:

    (a) Social benefit payments as defined by IPSAS 42;

    (b) Collective and Individual Services as defined in the IPSASB amending standard *Collective and Individual Services (Amendments to IPSAS 19 Provisions, Contingent Liabilities and Contingent Assets)*;

    (c) Lease contracts within the scope of PBE IPSAS 13 *Leases*;

    (d) Contributions and distributions to owners in their capacity as owners;

    (e) Service concession arrangements as defined in PBE IPSAS 32, *Service Concession Arrangements: Grantor*;

    (f) Employee benefits as defined in PBE IPSAS 39 *Employee Benefits;*

    (g) Financial instruments, including concessionary loans, as defined in PBE IPSAS 41 *Financial Instruments;*

    (h) Insurance contracts within the scope of PBE IFRS 17 *Insurance Contracts*;

    (i) Changes in the value of current and non-current assets arising from subsequent measurement;

    (j) Initial recognition or changes in the fair value of biological assets related to agricultural activity; and

    (k) The extraction of mineral resources

12. It is important to keep in mind that the project scope only includes *transfer* expenses. It therefore excludes the standard exchange-like transactions that involve the purchase of goods or services from suppliers on a commercial (arms-length) basis.

13. We note the IPSASB has issued three standards that seek to cover the range of non-exchange expense transactions that arise in the public sector:

(a) *Collective and Individual Services (Amendments to IPSAS 19 Provisions, Contingent Liabilities and Contingent Assets*;

(b) IPSAS 42 *Social Benefits;* and

(c) IPSAS 48 *Transfer Expenses*.

14. The Board has asked for further analysis on the scope and impact of the new IPSAS for collective services[2], individual services[3], and social benefits[4] before commencing projects to develop PBE standards for these expense transactions. The Board has also asked for further analysis to understand how these developments interact with the principles within IPSAS 48 and other existing PBE standards (for example PBE IFRS 17 *Insurance Contracts)*.

15. The outcome of this further analysis, which will be considered at a future NZASB meeting, may result in amendments to the scope of this project and/or the introduction of new separate standard-setting projects.

Key issues

16. As part of the process of developing a PBE ED for Transfer Expenses is the consideration of any New Zealand-specific issues, areas where additional guidance is required (especially for application by not-for-profit entities), and any other areas for improvement to ensure the standard is fit-for-purpose for preparers and will meet PBE user-needs.

17. Based on feedback received from New Zealand constituents (and review of previous NZASB submissions) in responses to IPSASB consultations on transfer expenses, recent discussions with representatives from the PBE sector[5], and staff analysis of IPSAS 48 — we have identified the following key issues for consideration when developing a PBE Standard using IPSAS 48 as a starting point.

Table 1: Key issues

Topic	Issue
#1: Consistency of expense recognition principles in IPSAS 48 with the conceptual framework	A key principle of IPSAS 48 is the recognition of an asset for an outflow of resources arising from a binding arrangement where the resource recipient has not fully satisfied the agreed compliance obligations at the reporting date. The asset represents the resource provider's (i.e., the entity incurring the expense) ability to compel a resource recipient to satisfy the agreed compliance obligations or seek remedies for non-performance (they

2 Collective services are services provided by a public sector entity simultaneously to all members of the community that are intended to address the needs of society as a whole – for example expenditure related to the provision of defence and street lighting.

3 Individual services are goods and services provided to individuals and/or households by a public sector entity that are intended to address the needs of society as a whole – for example expenditure related to provision of healthcare and education services.

4 Social benefits as defined by IPSAS 42, are cash transfers provided to: (a) Specific individuals and/or households who meet eligibility criteria; (b) Mitigate the effect of social risks; and (c) Address the needs of society as a whole.

5 We met with PBE sector representatives on 23 June to discuss current issues with accounting for transfer expenses in practice. Attendance included representatives from Treasury, OAG, Audit NZ, Wellington City Council, Auckland City Council, and a practitioner with not-for-profit reporting experience.

Topic	Issue
	may include the return of the funds or some other form of penalty). An asset can only be recognised if the compliance obligations are enforceable, and the resource provider has the ability to reliably measure the resource recipient's satisfaction of those compliance obligations. The concept of recognising an asset when the reporting entity has lost control of the resources (e.g. after a grant has been paid) is somewhat of a new concept. It will be important for the NZASB to be comfortable that the recognition of an asset in these circumstances is consistent with the conceptual framework principles.
#2 Introduction of new terminology	We note that IPSAS 48 introduces several new terms, such as "transfer expenses", and new concepts such as "transfer right asset". These terms could be confusing for entities, especially not-for-profit entities. We will consider the need to amend the standard (including terminology) to improve the understandability and accessibility of the new PBE standard.
#3 Scope	The definition of *transfer expenses* used in IPSAS 48 may not be immediately understandable for both public sector and not-for-profit users. We will consider developing additional guidance. Increased clarity will also likely be needed to explain the boundaries of the proposed new transfer expenses standard and how it interacts with other existing PBE standards (and IPSASs on non-exchange expense transactions not yet incorporated into the PBE Standards – Social Benefits, Collective Services, and Individual Services).
#4 Multi-year and milestone-based funding arrangements	The additional "complexity" that comes from multi-year arrangements lies in the timing differences between when funding is transferred (i.e., paid) and whether that funding is required to be recognised as an expense immediately when entering into the binding arrangement. Milestone-based funding arrangements require consideration of when the transfer recipient becomes entitled to payment from the resource provider (and likewise, when the resource provider becomes obligated to make the payment). The accounting for both types of arrangement has been identified as an issue by New Zealand PBEs. The accounting principles in IPSAS 48 address these issues, by prompting the entity to consider whether the obligation to incur an outflow of resources meets the definition of a liability, and if there are any associated enforceable obligations that meet the definition of an asset (which would defer expense recognition). XRB staff will consider whether the guidance provided in IPSAS 48 is sufficient and if additional illustrative examples are needed to support consistent application by PBEs.

Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Project timeline

18. A summary of the indicative project timeline is provided in Figure 1 below.

Figure 1

19. Table 2 provides further detail of the actions planned throughout the development of the PBE Standard. It also sets out our initial thoughts on recommended outreach activities for the ED (which will be supported by a full Communication Plan developed closer to the time).

Table 2: Detail of estimated timeline for development of PBE IPSAS 48 *Transfer Expenses*

Date (estimated)	Project activity
Jun 2023	NZASB applied the PBE Policy Approach and agreed in principle to go ahead with the project with an initial focus to address the concerns raised by the Board regarding the recognition of a liability and/or asset when applying the requirements of IPSAS 47 *Revenue* and IPSAS 48 *Transfer Expenses* in contrast to the definitions in the IPSAS Conceptual Framework. Refer to focus areas below.
Aug 2023	10 August 2023 NZASB Meeting Staff seek NZASB feedback on the project plan to develop a new PBE Standard using IPSAS 48 as a starting point; and Staff seek feedback from the NZASB on preliminary views on the focus areas for development of the new PBE Standard.
Discussion of issues (two NZASB meetings)	
Sep-Dec 2023	Staff performs analysis on focus areas to present conclusions at October 2023 and December 2023 NZASB meetings. The proposed coverage of the focus areas, at the respective meetings, is as follows: 19 October 2023 NZASB meeting • To ensure appropriate guidance is provided (for the PBE Standard) concerning key definitions that underpin the transfer expense accounting principles — "binding arrangement", "enforceability" and "compliance obligation"; and • To ensure the Board is comfortable that the recognition of a liability (deferral of revenue recognition) and/or asset when applying the requirements of IPSAS 47 *Revenue* and IPSAS 48 *Transfer Expenses* for different classes of transactions is consistent with the definitions and recognition criteria in the XRB's PBE Conceptual Framework. • The scope of the new PBE Standard on transfer expenses and how it interacts with other existing PBE standards (and IPSAS on non-exchange expense transactions not yet incorporated into the PBE Standards – Social Benefits, Collective Services, and Individual Services). 13 December 2023 NZASB meeting Discussion of other issues identified by staff or raised in the NZASB comment letter on the IPSASB EDs. • Multi-year and milestone-based funding arrangements. • Introduction of new terminology. • Other issues raised by New Zealand constituents during the IPSASB ED stage.

Date (estimated)	Project activity
Development and approval of PBE ED (two NZASB meetings)	
Jan-Mar 2024	Drafting of the ED and Consultation Paper. The drafting process for the ED will involve consideration of the readability and understandability of PBE IPSAS 48. Specifically, the following actions will be considered during the drafting process. • Renaming terms and concepts to align more with the New Zealand experience. • Rearranging the core text and application guidance paragraphs so that the requirements of the standard and the explanatory text is included in one place for ease of reading. • Incorporating the relevant requirements in other Standards (such as in PBE IPSAS 19) into the new PBE Standard. It will also be considered whether the illustrative examples are sufficient in the New Zealand context. We expect that this process will be performed with support from a sub-board of the NZASB. Furthermore, during this phase staff will also check in with PBE sector representatives to ensure we captured all key issues.
Mar 2024	28 March NZASB Meeting NZASB to consider the working draft of the ED and Consultation Document.
May 2024	9 May 2024 NZASB Meeting NZASB to approve ED PBE IPSAS 48 *Transfer Expenses* and the Consultation Document for publication.
PBE ED on Transfer Expenses open for consultation (4 months)	
May-Aug 2024	Staff undertakes targeted and broad-scope outreach activities which will include: • Notification to constituents about the EDs via an NZASB Update. • Promote awareness of, and seek feedback on, the proposals at the Public Sector Advisory Group. • Roundtable discussions with representatives from the public sector and not-for-profit sector. • Liaise with Charities Services staff about promoting awareness via the Charities Services' newsletter and website. • Host webinars to explain the Standard and raise awareness of the changes. • Promote awareness of the proposals at relevant conferences and events occurring during this time. • In addition, we will contact New Zealand respondents who commented on the IPSASB consultation papers and EDs.

Date (estimated)	Project activity
Analysis of feedback and development of PBE Standard (two meetings)	
Sep 2024	Staff analyse feedback received on the ED.
Oct 2024	15 October 2024 NZASB Meeting NZASB to consider staff's analysis of feedback received on ED PBE IPSAS 48 *Transfer Expenses.*
Dec 2024	4 December 2024 NZASB Meeting NZASB to consider staff's recommended changes in response to ED feedback.
Approval and issue of PBE IPSAS 48	
Feb 2025	February 2025 NZASB Meeting NZASB to approve the final draft of PBE IPSAS 48.
Mar 2025	PBE IPSAS 48 is issued and becomes effective for periods beginning on or after 1 July 2027.