Grant Thornton
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Navigating the changes to New Zealand Equivalents to International Financial Reporting Standards

April 2019

Contents

Overview

This publication is designed to give a high-level awareness of recent changes to New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) that will affect future financial reporting for for-profit entities. It covers both new standards and interpretations that have been issued and amendments made to existing ones.

What is new in 2019?

This publication covers 31 March 2019 financial year ends and details the NZ IFRSs that have been approved and published by the New Zealand Accounting Standards Board (NZASB) of the External Reporting Board (XRB) for accounting periods beginning on or after 1 January 2018.

Effective dates of the new standards

Pages 4 and 5 identify the changes that will affect you. It lists all the changes covered in this publication, and whether early application is permitted.

Where a change is not yet mandatorily effective for a particular year end, it may still be possible for an entity to adopt it early, dependent upon any special directive provided by the NZASB.

Where a change has been made but an entity is yet to apply it, certain disclosures are required to be made under NZ IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Disclosures required include the fact that the new or amended Standard or Interpretation is issued, but has not yet been applied, and known or reasonably estimable information relevant to assessing its possible impact of the financial statements in the period of initial application.

Identifying the commercial significance of the changes

For each change we have included a box on its commercial implications. These sections focus on the following questions:

- how many entities will be affected?
- what will be the impact on affected entities?

Grant Thornton New Zealand Limited
April 2019

Effective dates of new standards, interpretations and amendments (issued by XRB as at 28 February 2019)

Standard(s)	Title of standard or interpretation	Effective for accounting periods beginning on or after	Page	For 31 March year ends
NZ IFRS 15	Revenue from Contracts with Customers	1 January 2018	7	Effective for the first time for accounting periods ending on or after 31 March 2019
NZ IFRS 9 (2014)	Financial Instruments	1 January 2018	12	Effective for the first time for accounting periods ending on or after 31 March 2019
NZ IFRS 4	Applying NZ IFRS 9 Financial Instruments with NZ IFRS 4 Insurance Contracts (Amendments to NZ IFRS 4)	1 January 2018	18	Effective for the first time for accounting periods beginning on or after 1 January 2018
NZ IFRS 2	Classification and Measurement of Share-based payment Transactions (Amendments to NZ IFRS 2)	1 January 2018	20	Effective for the first time for accounting periods beginning on or after 1 January 2018
Various	Annual Improvements to NZ IFRSs 2014–2016 Cycle	1 January 2018	22	Effective for the first time for accounting periods beginning on or after 1 January 2018
NZ IFRIC 22	Foreign Currency Translation and Advance Consideration	1 January 2018	23	Effective for the first time for accounting periods beginning on or after 1 January 2018
NZ IAS 40	Transfers of Investment Property (Amendments to NZ IAS 40)	1 January 2018	24	Effective for the first time for accounting periods beginning on or after 1 January 2018
Various	2017 Omnibus Amendments to NZ IFRS	1 January 2018	25	Effective for the first time for accounting periods beginning on or after 1 January 2018
NZ IFRS 16	Leases	1 January 2019	27	Not yet effective (Effective for accounting periods ending on or after 31 March 2020)
NZ IFRS 9	Prepayment Features with Negative Compensation (Amendments to NZ IFRS 9)	1 January 2019	32	Not yet effective (Effective for accounting periods beginning on or after 1 January 2019)
Various	2017 Omnibus Amendments to NZ IFRS	1 January 2019	33	Not yet effective (Effective for accounting periods beginning on or after 1 January 2019)

Standard(s)	Title of standard or interpretation	Effective for accounting periods beginning on or after	Page	For 31 March year ends
NZ IFRIC 23	Uncertainty over Income Tax Treatments	1 January 2019	34	Not yet effective (Effective for accounting periods beginning on or after 1 January 2019)
NZ IAS 28	Long-term Interests in Associates and Joint Ventures (Amendments to NZ IAS 28)	1 January 2019	36	Not yet effective (Effective for accounting periods beginning on or after 1 January 2019)
NZ IAS 19	Plan Amendment, Curtailment or Settlement (Amendments to NZ IAS 19)	1 January 2019	37	Not yet effective (Effective for accounting periods beginning on or after 1 January 2019)
Various	Annual Improvements to NZ IFRSs 2015-2017 Cycle	1 January 2019	38	Not yet effective (Effective for accounting periods beginning on or after 1 January 2019)
NZ IFRS 16 and NZ IAS 7	RDR NZ IFRS 16 and NZ IAS 7	1 January 2019	39	Not yet effective (Effective for accounting periods beginning on or after 1 January 2019)
FRS-42	Amendments to the scope of FRS-42	1 January 2019	40	Not yet effective (Effective for accounting periods beginning on or after 1 January 2019)
NZ IFRS 10 and NZ IAS 28	Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to NZ IFRS 10 and NZ IAS 28)	1 January 2020	42	Not yet effective (Effective for accounting periods ending on or after 31 March 2020)
NZ IAS 1 and NZ IAS 8	Definition of Material (Amendments to NZ IAS 1 and NZ IAS 8)	1 January 2020	44	Not yet effective (Effective for accounting periods beginning on or after 1 January 2020)
NZ Framework (2010), 2018 NZ Conceptual Framework	Definition of Material (Amendments to Conceptual Frameworks)	1 January 2020	46	Not yet effective (Effective for accounting periods beginning on or after 1 January 2020)
2018 NZ Conceptual Framework	New Zealand Equivalent to the IASB Conceptual Framework for Financial Reporting (2018 NZ Conceptual Framework)	1 January 2020	47	Not yet effective (Effective for accounting periods beginning on or after 1 January 2020)
NZ IFRS 3	Definition of a business (Amendments to NZ IFRS 3)	1 January 2020	49	Not yet effective (Effective for accounting periods beginning on or after 1 January 2020)
NZ IFRS 17	Insurance Contracts	1 January 2021[1]	53	Not yet effective (Effective for accounting periods ending on or after 31 March 2022)
Practice Statement 2	Making material judgements	No effective date	58	No effective date as non-mandatory guidance

[1]In November 2018 the IASB indicated that it was looking to postpone this application date by one year to 1 January 2020. This decision has still to be ratified by the NZASB.

Effective from 1 January 2018

The following standards, interpretation and amendments are effective for accounting periods beginning on or after 1 January 2018. It may be possible to apply these changes early.

The standards, interpretation and amendments are:

- NZ IFRS 15 Revenue from Contracts with Customers
- NZ IFRS 9 (2014) Financial Instruments
- Applying NZ IFRS 9 Financial Instruments with NZ IFRS 4 Insurance Contracts (Amendments to NZ IFRS 4)
- Classification and Measurement of Share-based Payment Transactions (Amendments to NZ IFRS 2)
- Annual Improvements to NZ IFRSs 2014-2016 Cycle
- NZ IFRIC 22 Foreign Currency Translation and Advance Consideration
- Transfers of Investment Property (Amendments to NZ IAS 40)
- 2017 Omnibus Amendments to NZ IFRS

NZ IFRS 15 Revenue from Contracts with Customers

Background

NZ IFRS 15 Revenue from Contracts with Customers is the New Zealand equivalent of IFRS 15 Revenue from Contracts with Customers: issued by the IASB. Prior to the issuance of IFRS 15, the previous requirements of IFRS and US GAAP were not harmonised and often resulted in different accounting treatments for economically significant transactions. In response, the Boards have developed new, converged requirements for the recognition of revenue under both IFRS and US GAAP and the NZASB has endorsed these without any changes for New Zealand.

The standard:

- replaces NZ IAS 18 Revenue, NZ IAS 11 Construction Contracts and some revenue-related Interpretations
- establishes a new control-based revenue recognition model
- changes the basis for deciding whether revenue is recognised at a point in time or over time
- provides new and more detailed guidance on specific topics
- expands and improves disclosures about revenue.

NZ IFRS 15 at a glance

Features	Key points
Who is affected?	• all entities that enter into contracts with customers with few exceptions.
What is the impact?	• entities affected will need to reassess their revenue recognition policies and may need to revise them;
	• the timing and amount of revenue recognised may not change for simple contracts for a single deliverable but most complex arrangements will be affected to some extent;
	• NZ IFRS 15 requires more and different disclosures.
When are the changes effective?	• annual periods beginning on or after 1 January 2018;
	• early application is permitted.

There is a five step model for revenue recognition which is detailed below:

A five step model for revenue recognition

1	2	3	4	5
Identify the contract(s) with the customer	Identify the separate performance obligations	Determine the transaction price	Allocate the transaction price	Recognise revenue when or as an entity satisfies performance obligations

NZ IFRS 15 is based on a core principle that requires an entity to recognise revenue:

- in a manner that depicts the transfer of goods or services to customers
- at an amount that reflects the consideration the entity expects to be entitled to in exchange for those goods or services.

A "customer" is defined as "a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities."

Applying this core principle involves following a five step model depicted above. The following table expands on the factors to consider in applying this new five step model.

Step	Principal considerations	Other factors to consider
1 Identify the contract(s) with a customer	The first step in NZ IFRS 15 is to identify the "contract," which NZ IFRS 15 defines as "an agreement between two or more parties that creates enforceable rights and obligations." A contract can be written, oral, or implied by an entity's customary business practices. In addition the general NZ IFRS 15 model applies only when or if: • the contract has commercial substance; • the parties have approved the contract; • the entity can identify: – each party's rights – the payment terms for the goods and services to be transferred; and • it is probable the entity will collect the consideration. If a customer contract does not meet these criteria, revenue is recognised only when either: • the entity's performance is complete and substantially all of the consideration in the arrangement has been collected and is non-refundable; or • the contract has been terminated and the consideration received is non-refundable. For purposes of NZ IFRS 15, a contract does not exist if each party has an enforceable right to terminate a wholly unperformed contract without compensating the other party.	Guidance is also given on: • combining contracts; and • contract modifications.
2 Identify the separate performance obligations in the contract	Having identified a contract, the entity next identifies the performance obligations within that contract. A performance obligation is a promise in a contract with a customer to transfer either (1) a good or service, or a bundle of goods or services that is "distinct"; or (2) a series of distinct goods or services that are substantially the same and meet certain criteria. Performance obligations are normally specified in the contract but could also include promises implied by an entity's customary business practices, published policies or specific statements that create a valid customer expectation that goods or services will be transferred under the contract.	Guidance is given on the criteria that need to be met in order to determine whether a promised good or service is distinct.
3 Determine the transaction price	Under NZ IFRS 15, the "transaction price" is defined as the amount of consideration an entity expects to be entitled to in exchange for the goods or services promised under a contract, excluding any amounts collected on behalf of third parties (for example, sales taxes). The transaction price is not adjusted for effects of the customer's credit risk, but is adjusted if the entity (eg based on its customary business practices) has created a valid expectation that it will enforce its rights for only a portion of the contract price.	An entity must consider the effects of all the following factors when determining the transaction price: • variable consideration; • the constraint on variable consideration; • time value of money; • non-cash consideration; and • consideration payable to the customer.
4 Allocate the transaction price to the performance obligations	Under NZ IFRS 15, an entity allocates a contract's transaction price to each separate performance obligation within that contract on a relative stand-alone selling price basis at contract inception. NZ IFRS 15 defines a stand-alone selling price as "the price at which an entity would sell a promised good or service separately to a customer."	NZ IFRS 15 suggests, but does not require, the following three methods as suitable for estimating the stand-alone selling price: • adjusted market assessment approach; • expected cost plus margin approach; or the • residual approach.

Step	Principal considerations	Other factors to consider
5 **Recognise revenue when or as an entity satisfies performance obligations**	Under NZ IFRS 15, an entity recognises revenue when or as it transfers promised goods or services to a customer. A "transfer" occurs when the customer obtains control of the good or service. A customer obtains control of an asset (good or service) when it can direct the use of and obtain substantially all the remaining benefits from it. Control includes the ability to prevent other entities from directing the use of and obtaining the benefits from an asset. The benefits of an asset are the potential cash flows that can be obtained directly or indirectly from the asset in many ways.	A key part of the model is the concept that for some performance obligations control is transferred over time while for others control transfers at a point in time. Guidance is given in the Standard to help entities decide which is appropriate.

Other matters

In addition to the items discussed above in relation to the five step model, NZ IFRS 15 contains guidance on a number of other matters including:

- contract costs;
- warranties;
- licensing; and
- rights of return and repurchase obligations.

Transition

Entities are required to apply the new revenue Standard either:

- retrospectively to each prior period presented, subject to some practical expedients; or
- retrospectively, with the cumulative effect of initial application recognised in the current period.

An entity that chooses to restate only the current period is required to provide the following additional disclosures in the initial year of adoption:

- the current year impact of applying the new revenue Standard by financial statement line item; and
- an explanation of the reasons behind the significant impacts.

The NZASB took the IASB's 'Clarifications to IFRS 15 Revenue from Contracts with Customers' and made several targeted changes to NZ IFRS 15.

Clarifications

Following discussions with the Revenue Transition Resource Group (TRG), in April 2016, the IASB published Clarifications to IFRS 15 Revenue from Contracts with Customers (the 'Amendments') making several targeted changes to IFRS 15. The TRG was formed by both the FASB and the IASB Boards after issuing the new standards in 2014 and is tasked with supporting the implementation of IFRS 15. While a total of five topics discussed by the TRG indicated the possible need for clarification, the IASB has elected to address just 3 of these, striking a balance between being responsive to issues raised while minimising disruption to the implementation process. The Amendments also introduce two practical expedients available for use by entities implementing the new standard.

The Amendments clarified the application of NZ IFRS 15 in three specific areas to reduce the amount of diversity and practice that might otherwise result from differing views on how to implement the requirements of the new standard. They will help companies:

- identify performance obligations (by clarifying how to apply the concept of 'distinct');
- determine whether a company is a principal or an agent in a transaction (by clarifying how to apply the control principle); and
- determine whether a license transfers to a customer at a point in time or over time (by clarifying when a company's activities significantly affect the intellectual property to which the customer has rights).

The amendments also create two additional practical expedients available for use when implementing NZ IFRS 15:

- for contracts that have been modified before the beginning of the earliest period presented, the Amendments allow companies to use hindsight when identifying the performance obligations, determining the transaction price, and allocating the transaction price to the satisfied and unsatisfied performance obligations; and
- companies applying the full retrospective method are permitted to ignore contracts already complete at the beginning of the earliest period presented.

The Amendments are effective for annual periods beginning on or after 1 January 2018 (the effective date of the new Standard). Earlier application is permitted.

Commercial significance

Most

Number of entities affected

NZ IFRS 15 impacts all entities that enter into contracts with customers with few exceptions.

High

Impact on affected entities

The impact on the top line will very much depend on each entity's specific customer contracts and how the much less detailed existing standards have been applied. For some it will be a significant shift while others may see only minor changes.

NZ IFRS 9 (2014) Financial Instruments

The IASB began its overhaul of the accounting for financial instruments in the summer of 2009 in response to the widespread criticism of IAS 39 and its alleged role in contributing to the global financial crisis of 2007/8. Due to the complexity of the issues involved, the project was completed in a number of stages as follows, all of which were approved by the NZASB:

- November 2009: the classification and measurement of financial assets
- October 2010: requirements for classifying and measuring financial liabilities and derecognising financial assets and financial liabilities were added
- November 2013: requirements on hedge accounting were introduced
- July 2014: the IASB issued IFRS 9 (2014) adding requirements on impairment and amending the Standard's classification and measurement requirements.
- September 2014: the NZASB published the New Zealand equivalent of IFRS 9 (2014) as NZ IFRS 9 (2014).

Following the publication of NZ IFRS 9 (2014) the Standard as a whole is now complete. The different parts of the Standard are discussed in greater detail below.

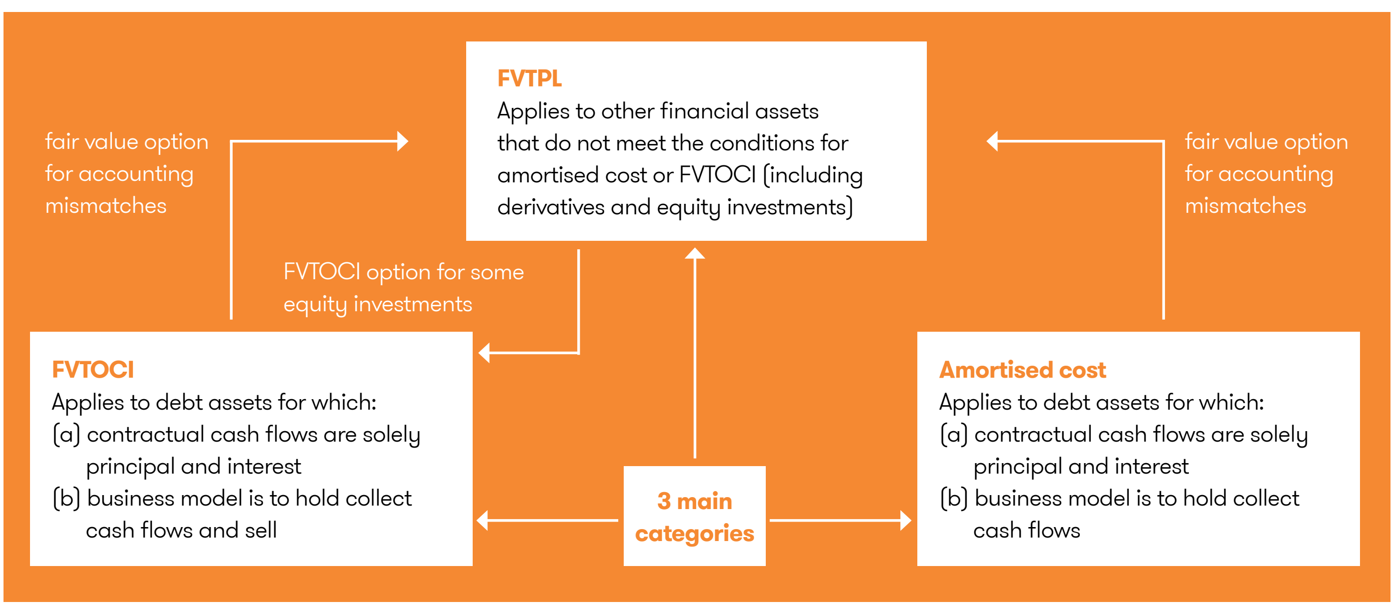
Classification and measurement of financial assets

The classification and measurement of financial assets was one of the areas of IAS 39 that received the most criticism during the financial crisis. In publishing the original version of IFRS 9, the IASB therefore made a conscious effort to reduce the complexity in accounting for financial assets by just having two categories (fair value and amortised cost). However following comments that having just two categories created too sharp a dividing line and failed to reflect the way many businesses manage their financial assets, an additional category was added in July 2014 when IFRS 9 (2014) was published.

Classification

Under NZ IFRS 9 each financial asset is classified into one of three main classification categories as shown below namely:

- amortised cost
- fair value through other comprehensive income (FVTOCI)
- fair value through profit or loss (FVTPL).



The classification is determined by both:

1 the entity's business model for managing the financial asset ('business model test'); and

2 the contractual cash flow characteristics of the financial asset ('cash flow characteristics test').

The diagram above summarises the three main categories and how the business model and cash flow characteristics determine the applicable category.

In addition, NZ IFRS 9 contains an option which allows an entity to designate a financial asset at fair value through profit or loss and an additional option to classify investments in equity instruments in a special 'equity – FVTOCI' category.

The business model test

NZ IFRS 9 uses the term 'business model' in terms of how financial assets are managed and the extent to which cash flows will result from collecting contractual cash flows, selling financial assets or both. The Standard positively defines two such 'business models':

- a business model whose objective is to hold the financial asset in order to collect contractual cash flows ('hold to collect'); and
- a business model in which assets are managed to achieve a particular objective by both collecting contractual cash flows and selling financial assets ('hold to collect and sell').

Business models other than the two above result in classification of financial assets at fair value through profit or loss.

The cash flow characteristics test

The second condition for classification in the amortised cost classification or FVTOCI category can be labelled the 'solely payments of principal and interest' (SPPI) test. The requirement is that the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

For the purpose of applying this test, 'principal' is the fair value of the financial asset at initial recognition. 'Interest' consists of consideration for:

- the time value of money;
- the credit risk associated with the principal amount outstanding during a particular period of time;
- other basic lending risks and costs; and
- a profit margin.

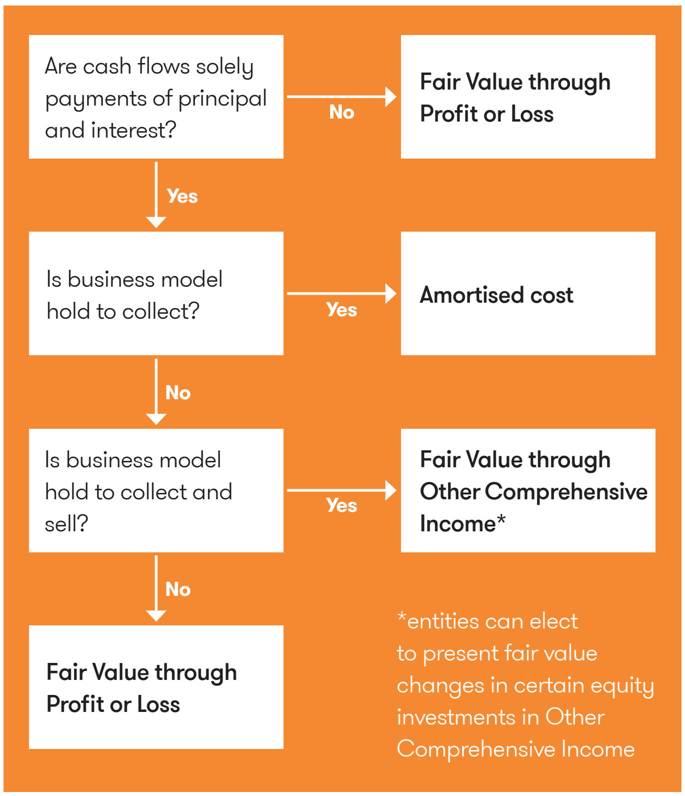
Contractual cash flows that are SPPI are consistent with a basic lending arrangement. Contractual terms that introduce exposures to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement however, such as exposure to changes in equity prices or commodity prices, fail the SPPI test. Similarly contracts that increase leverage fail the test as they increase the variability of the contractual cash flows with the result that they do not have the economic characteristics of interest.

The diagram on the following page shows the NZ IFRS 9 business model and how the cash flow characteristics test interact in determining the classification of financial assets.

NZ IFRS 9 introduces:

- a new approach for financial asset clarification
- a more forward-looking expected credit loss impairment model
- more flexible requirements to enable hedge accounting

Summary of NZ IFRS 9's classification model for financial assets



Classification and measurement of financial liabilities

Most of NZ IAS 39's requirements have been carried forward unchanged to NZ IFRS 9. Changes were however made to address issues related to own credit risk where an entity takes the option to measure financial liabilities at fair value.

Majority of requirements retained

Under NZ IAS 39 most liabilities are measured at amortised cost or bifurcated into a host instrument measured at amortised cost, and an embedded derivative, measured at fair value.

Liabilities that are held for trading (including all derivative liabilities) are measured at fair value. These requirements have been retained.

Own credit risk

The requirements related to the fair value option for financial liabilities have however been changed to address own credit risk. Where an entity chooses to measure its own debt at fair value, NZ IFRS 9 now requires the amount of the change in fair value due to changes in the entity's own credit risk to be presented in other comprehensive income. This change addresses the counter-intuitive way in which a company in financial trouble was previously able to recognise a gain based on its theoretical ability to buy back its own debt at a reduced cost.

The only exception to the new requirement is where the effects of changes in the liability's credit risk would create or enlarge an accounting mismatch in profit or loss, in which case all gains or losses on that liability are to be presented in profit or loss.

Elimination of the exception from fair value measurement for certain derivative liabilities

NZ IFRS 9 now eliminates the exception from fair value measurement for derivative liabilities that are linked to and must be settled by delivery of an unquoted equity instrument.

Under NZ IAS 39, if those derivatives were not reliably measurable, they were required to be measured at cost. NZ IFRS 9 requires them to be measured at fair value.

Simplifications compared to NZ IAS 39

Features	Key points
Objective of the standard	• to better align hedging from an accounting point of view with entities' underlying risk management activities.
Similarities with NZ IAS 39	• hedge accounting remains an optional choice; • the three types of hedge accounting (fair value hedges, cash flow hedges and hedges of a net investment) remain; • formal designation and documentation of hedge accounting relationships is required; • ineffectiveness needs to be measured and included in profit or loss; • hedge accounting cannot be applied retrospectively.
The major changes	• increased eligibility of hedged items; • increased eligibility of hedging instruments and reduced volatility; • revised criteria for hedge accounting qualification and for measuring hedge ineffectiveness; • a new concept of rebalancing hedging relationships; • new requirements restricting the discontinuance of hedge accounting.

Derecognition of financial assets and financial liabilities

The requirements in NZ IAS 39 related to the derecognition of financial assets and financial liabilities were incorporated unchanged into NZ IFRS 9.

The IASB had originally envisaged making changes to the derecognition requirements of IAS 39 but then subsequently concluded that IAS 39's requirements in this area had performed reasonably well during the financial crisis. As a consequence of this, NZ IAS 39's derecognition requirements were incorporated into NZ IFRS 9 unchanged, while new disclosure requirements were instead issued by the NZASB as an amendment to NZ IFRS 7 Financial Instruments: Disclosures.

Hedge accounting

NZ IAS 39's hedge accounting requirements were heavily criticised for containing complex rules which either made it impossible for entities to use hedge accounting or, in some cases, simply put them off doing so. As an example, hedge effectiveness was judged on both a prospective and retrospective basis, with a "bright-line" quantitative range of 80% to 125% being used to assess retrospective effectives on a quantitative basis. Anything outside this range resulted in the discontinuance of hedge accounting, leading to a sharp increase in volatility in the statements of profit or loss.

In part this complexity was a reflection of the fact that the hedge accounting requirements were an exception to NZ IAS 39's normal requirements. There was however also a perception that hedge accounting did not properly reflect entities' actual risk management activities, thereby reducing the usefulness of their financial statements. NZ IFRS 9's new requirements look to rectify some of these problems, aligning hedge accounting more closely with entities' risk management activities by:

- increasing the eligibility of both hedged items and hedging instruments; and
- introducing a more principles-based approach to assessing hedge effectiveness.

As a result, the new requirements should serve to reduce profit or loss volatility. The increased flexibility of the new requirements are however partly offset by entities being prohibited from voluntarily discontinuing hedge accounting and also by enhanced disclosure requirements. The simplifications table noted above gives a highly summarised view of the new hedging requirements.

Impairment

NZ IFRS 9 (2014) contains the Standard's requirements on impairment, including the recognition of expected credit losses. NZ IAS 39's impairment requirements had been criticised for being overly complicated and resulting in impairment being recognised at too late a stage. NZ IFRS 9 (2014) addresses these criticisms by applying the same impairment model to all financial instruments that are subject to impairment accounting and by using more forward-looking information. In applying this more forward-looking approach, a distinction is made between:

- financial instruments that have not deteriorated significantly in credit quality since initial recognition or that have low credit risk
- financial instruments that have deteriorated significantly in credit quality since initial recognition and whose credit risk is not low.

'12-month expected credit losses' are recognised for the first category while 'lifetime expected credit losses' are recognised for the second category. There is also a third step to the model in the sense that for assets which actually become credit-impaired after initial recognition, interest is calculated on the asset's amortised cost (i.e. the amount net of the loss allowance) as opposed to its gross carrying amount

'Extensive transition provisions have been included due to the complexity of the material and the phased way in which the project has been completed.'

Expected credit losses

Deterioration in credit quality

Stage 1 - Performing

- financial instruments that have not deteriorated significantly in credit quality since initial recognition or that have low credit risk at the reporting date
- 12-month expected credit losses are recognised
- interest revenue is calculated on the gross carrying amount of the asset.

Stage 2 - Underperforming

- financial instruments that have deteriorated significantly in credit quality since initial recognition (unless they have low credit risk at the reporting date) but that do not have objective evidence of a credit loss event
- lifetime expected credit losses are recognised
- interest revenue is still calculated on the asset's gross carrying amount.

Stage 3 - Non-performing

- financial assets that have objective evidence of impairment at the reporting date
- lifetime expected credit losses are recognised
- interest revenue is calculated on the net carrying amount (ie reduced for expected credit losses).

Credit risk = low

Credit risk > low

Transition

Extensive transition provisions have been included due to the complexity of the material and the phased way in which the project has been completed.

Commercial significance

Most

Number of entities affected

Because the definition of a financial instrument is so wide, most entities can expect to be affected. Even entities with relatively simple debtors and creditors should consider the changes. In addition, the greater alignment of NZ IFRS 9's hedge accounting requirements with entities risk management practices may encourage entities who engage in economic hedging to also apply hedge accounting.

High

Impact on affected entities

The new Standard, with its reduced number of measurement categories, should help to reduce the complexity in accounting for financial instruments. In the short-term however, it may lead to far reaching changes, with entities needing to re-evaluate the classification of all instruments within the scope of NZ IAS 39.

In addition to the impact on entities' financial position and reported results, many businesses will need to collect and analyse additional data and implement changes to systems in order to implement the new requirements on impairment.

Applying NZ IFRS 9 Financial Instruments with NZ IFRS 4 Insurance Contracts (Amendments to NZ IFRS 4)

In September 2016, the IASB published Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts which makes narrow scope amendments to IFRS 4 Insurance Contracts. The IASB issued the amendments to address the temporary accounting consequences of the different effective dates of IFRS 9 'Financial Instruments' and the anticipated new insurance contracts Standard. The new insurance contracts standard is yet to be finalised and will have an effective date of 1 January 2021. This means its mandatory effective date will be after the 2018 effective date of NZ IFRS 9.

As entities that issue insurance contracts will be affected by both NZ IFRS 9 and the new insurance contracts standard, there was considerable concern over the practical challenges of implementing these two significant accounting changes on different dates. Further concerns were raised over the potential for increased volatility in profit or loss if NZ IFRS 9's new requirements for financial instruments come into force before the new insurance accounting rules.

To address these concerns while still fulfilling the needs of users of financial statements, the IASB responded by amending IFRS 4. Consequently, the NZASB has endorsed these changes and has taken them in to NZ IFRS. The amendments introduce the:

- overlay approach – an option for all entities that issue insurance contracts to adjust profit or loss for eligible financial assets by removing any additional accounting volatility that may arise as a result of NZ IFRS 9; and
- a temporary exemption – an optional temporary exemption from applying NZ IFRS 9 for entities whose activities are predominantly connected with insurance. These entities will be permitted to continue to apply the existing financial instrument requirements of NZ IAS 39.

Overlay approach

The overlay approach aims to remove from profit or loss any additional volatility that may arise if NZ IFRS 9 is applied together with NZ IFRS 4. All entities would be permitted to apply it but only to certain assets (see below). Furthermore, the approach must be chosen on the initial adoption of NZ IFRS 9.

Entities applying the overlay approach are required to apply NZ IFRS 9 from its 1 January 2018 effective date. However they are permitted to reclassify from profit or loss to other comprehensive income an amount equal to the difference between:

- the amount reported in profit or loss when NZ IFRS 9 is applied to the qualifying financial assets (see below); and
- the amount that would have been reported in profit or loss if NZ IAS 39 were applied to those assets.

The amendments require the reclassification to be shown as a separate line item on the face of the statement of both profit or loss and other comprehensive income, with additional disclosures being given in order to enable users to understand it.

Only financial assets that meet both of the following criteria would qualify for the overlay approach:

- the financial assets are measured at fair value through profit or loss when applying NZ IFRS 9 but would not have been so measured in their entirety when applying NZ IAS 39; and
- the financial assets are designated by the entity as relating to insurance activities for the purposes of the overlay approach.

Temporary exemption

Temporary exemption is an option for entities whose activities are predominantly connected with insurance to defer the application of NZ IFRS 9 until the earlier of:

- the application of the new insurance contracts standard, or
- 1 January 2021.

If an entity elects to use this temporary exemption, it will continue to apply NZ IAS 39 during this period and will be required to provide some key disclosures to assist users of financial statements to make comparisons with entities applying NZ IFRS 9.

Entities are eligible for this deferral approach only if they have activities that are predominantly connected with insurance when considering their activities as a whole. This should be considered at the reporting entity level and they must not have previously applied NZ IFRS 9.

As eligibility is assessed at a reporting entity level, a separate assessment should be made for separate financial statements and consolidated groups. It is therefore possible for a group still to be eligible for the exemption even if there is a non-qualifying subsidiary (for its individual financial statements) within the group, or vice versa.

Predominance should be assessed by comparing the amount of an entity's insurance contract liabilities with the total amount of its liabilities.

Unlike the overlay approach, the temporary exemption will be applied to all, rather than some, financial assets of the limited population of entities that qualify for and elect to apply this approach.

Effective date

The amendments are effective as follows:

- the overlay approach is applied when entities first apply NZ IFRS 9
- a temporary exemption from NZ IFRS 9 is applied for accounting periods on or after 1 January 2018.

Commercial significance

Some

Number of entities affected

The amendments will only impact entities that issue insurance contracts, and will therefore be affected by both NZ IFRS 9 and the new insurance contracts standard.

High

Impact on affected entities

These amendments will provide relief to considerable concern raised over the practical challenges of adopting two significant standards on different dates.

The NZASB issued the amendments to address the temporary accounting consequences of the different effective dates of NZ IFRS 9 Financial Instruments and the new insurance contracts Standard, NZ IFRS 17.

Classification and Measurement of Share-based Payment Transactions (Amendments to NZ IFRS 2)

In April 2016 the IASB published Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2). The NZASB has endorsed the amendments and taken them into NZ IFRS. We describe the three changes made to NZ IFRS 2 by the amendments in more detail below.

Effects of vesting conditions on the measurement of a cash-settled share-based payment

Prior to the publication of these amendments, NZ IFRS did not specifically address the impact of vesting and non-vesting conditions on the measurement of the fair value of the liability incurred in a cash-settled share-based payment transaction. The amendments address this lack of guidance by clarifying that these conditions should be accounted for consistently with equity-settled share-based payments in NZ IFRS 2.

This means that the fair value of cash-settled awards is measured ignoring service and non-market performance conditions, but taking into account market and non-vesting conditions. This applies when estimating the fair value of the cash-settled share-based payment granted and when re-measuring the fair value at the end of each reporting period and at the date of settlement. The cumulative expense recognised is adjusted based on the number of awards that is ultimately expected to vest (the so-called 'true-up' mechanism).

Classification of share-based payment transactions with a net settlement feature for withholding tax obligations

The second amendment addresses the accounting for a particular type of share-based payment scheme. Many jurisdictions require entities to withhold an amount for an employee's tax obligation associated with share-based payments and transfer the amount (normally in cash) to the taxation authorities. As a result the terms of some schemes require the entity to deduct the number of equity instruments needed to equal the monetary value of the employee's tax obligation from the number of equity instruments that would otherwise be issued to the employee (referred to as a 'net settlement' feature).

The amendment stems from a request for guidance on whether the portion of the share-based payment that is withheld should be classified as cash-settled or equity-settled, where the entire share-based payment would otherwise have been classified as an equity-settled share-based payment transaction.

The amendment adds guidance to NZ IFRS 2 to the effect that a scheme with this type of compulsory net-settlement feature would be classified as equity-settled in its entirety (assuming it would be so classified without the net settlement feature). Where necessary, an entity shall disclose an estimate of the amount that it expects to transfer to the tax authority to settle the employee's tax obligation.

Accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled

The third amendment addresses the accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. Such situations were not previously addressed by NZ IFRS 2, so the NZASB has amended the Standard so that:

- the share-based payment transaction is measured by reference to the modification-date fair value of the equity instruments granted as a result of the modification;
- the liability recognised in respect of the original cash-settled share-based payment is derecognised upon the modification, and the equity-settled share-based payment is recognised (in equity) to the extent that the services have been rendered up to the modification date; and
- the difference between the carrying amount of the liability as at the modification date and the amount recognised in equity at the same date is recorded in profit or loss immediately.

Commercial significance

Few Number of entities affected

The amendments will only impact entities with share based payment transactions.

Medium Impact on affected entities

Some of the changes could have a fairly significant impact depending on the type of share-based payment transactions the entity has entered into.

The changes made to NZ IFRS 2 cover the following matters:

- the accounting for the effects of vesting conditions on the measurement of a cash-settled share-based payment
- the classification of share-based payment transactions with a net settlement feature for withholding tax obligations
- the accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled.

Annual Improvements to NZ IFRSs 2014-2016 Cycle

The Annual Improvements to NZ IFRSs 2014- 2016 Cycle is a collection of amendments to IFRSs resulting from issues that were discussed by the IASB during the project cycle for making annual improvements that began in 2014 and which were included in an Exposure Draft published in November 2015.

The IASB uses the process for making non-urgent, but necessary, minor amendments that will not be included as part of any other project and the NZASB has formed a similar view, by taking the IASB's proposed changes and putting them into their standards. By presenting the amendments in a single document rather than as a series of piecemeal changes, the IASB and the NZASB aim to ease the burden of change for all concerned. A summary of the issues addressed is set out in the table that follows.

Summary of Improvements to IFRSs 2014-2016

Standard affected	Subject	Summary of amendment
NZ IFRS 1 First-time Adoption of New Zealand equivalents to International Financial Reporting Standards	Deletion of short-term exemptions for first-time adopters	A number of short-term exemptions have been deleted because the reliefs provided are no longer available or because they were relevant for reporting periods that have now passed.
NZ IAS 28 Investments in Associates and Joint Ventures	Measuring an associate or joint venture at fair value	The amendment clarifies that the election by venture capital organisations, mutual funds, unit trusts and similar entities to measure investments in associates or joint ventures at fair value through profit or loss should be made separately for each associate or joint venture at initial recognition.

The amendments to these Standards are effective for annual periods beginning on or after 1 January 2018. The amendment to NZ IAS 28 shall be applied retrospectively with earlier application permitted.

Commercial significance

Few Number of entities affected

The amendments make changes to relatively narrow areas within NZ IFRSs.

Low Impact on affected entities

The Annual Improvements process addresses non-urgent, but necessary minor amendments to NZ IFRSs. By their nature then, their commercial significance can be expected to be low and overall the changes are largely uncontroversial.

NZ IFRIC 22 Foreign Currency Transactions and Advance Consideration

Background

Although NZ IAS 21 The Effects of Changes in Foreign Exchange Rates sets out requirements about which exchange rate to use when recording a foreign currency transaction on initial recognition in an entity's functional currency, IFRIC had observed diversity in practice in circumstances in which an entity recognises a non-monetary liability arising from advance consideration. The diversity resulted from the fact that some entities were recognising revenue using the spot exchange rate at the date of the receipt of the advance consideration while others were using the spot exchange rate at the date that revenue was recognised. In carrying out their analysis of the issue, IFRIC noted that the issue was not restricted to just revenue transactions. For example, the same issue arises for transactions such as a sale of property, plant and equipment or the purchase of services when consideration is denominated in a foreign currency and is paid or received in advance.

Action taken

NZ IFRIC 22 addresses this issue by clarifying that the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration. If there are multiple payments or receipts in advance, the entity shall determine a date of the transaction for each payment or receipt of advance consideration. Illustrative examples in the Interpretation demonstrate the application of this consensus.

Transition

On initial application, entities have the choice of applying the Interpretation either retrospectively or, alternatively, prospectively to all assets, expenses and income in the scope of the Interpretation initially recognised on or after:

i. the beginning of the reporting period in which the entity first applies the Interpretation, or

ii. the beginning of a prior reporting period presented as comparative information in the financial statements of the reporting period in which the entity first applies the Interpretation.

Commercial significance

Few

Number of entities affected

The Interpretation will affect entities recognising a non-monetary asset or non-monetary liability associated with the payment or receipt of advance consideration in a foreign denominated currency.

Low

Impact on affected entities

The commercial impact of the Interpretation is expected to be low for individual affected entities. It will however, reduce diversity in practice between affected entities.

Transfers of Investment Property (Amendments to NZ IAS 40)

Introduction
The IASB has published Transfers of Investment Property (Amendments to IAS 40) which clarifies that transfers to, or from, investment property are required when, and only when, there is a change in use of property supported by sufficient evidence. The amendments have been endorsed by the NZASB and taken in to NZ IFRS.

The amendments
In addition to clarifying the above-noted principle, the amendments also re-characterise the list of circumstances appearing in paragraph 57(a)–(d) as a non-exhaustive list of examples of evidence that a change in use has occurred. The Board has also clarified that a change in management's intent, by itself, does not provide sufficient evidence that a change in use has occurred. Evidence of a change in use must be observable.

Transition
The amendments contain transitional provisions, the default being prospective application, however retrospective application is permitted, provided that it is possible without the use of hindsight.

Commercial significance

Few — Number of entities affected

Qualifying entities transferring a property to or from 'investment property' upon a 'change in use'.

Low — Impact on affected entities

As the amendment concerns a clarification, the expected commercial impact is low.

2017 Omnibus Amendments to NZ IFRS

In November 2016 the NZASB issued a standard to provide disclosure concessions for Tier 2 for-profit entities applying NZ IFRS 7 Financial Instruments: Disclosures as amended by NZ IFRS 9 Financial Instruments. The disclosure concessions are identical to those issued by the IASB.

More specifically, the amendment adds paragraphs *35A-35N regarding disclosures on credit risk and *B8A-B8J regarding qualitative disclosures on the nature and extent of risks arising from financial instruments.

In addition in FRS-43 Summary Financial Statements, changes were made to align the titles of the financial statements with the wording in NZ IAS 1 and remove wording that was no longer applicable.

Changes were also made to NZ IFRS 4 Insurance Contracts and aligning wording in the standard to what appears in NZ IAS 27 Separate Financial Statements.

Commercial significance

Many

Number of entities affected

Many entities are affected including Tier 2 for-profit entities applying NZ IFRS 7.

Medium

Impact on affected entities

For affected Tier 2 entities, the commercial impact will be reduced disclosures in their annual financial statements. The other changes will affect few entities.

Effective from 1 January 2019

The following amendments are effective for accounting periods beginning on or after 1 January 2019. The amendments are:

- NZ IFRS 16 Leases
- Prepayment Features with Negative Compensation (Amendments to NZ IFRS 9)
- 2017 Omnibus Amendments to NZ IFRS
- NZ IFRIC 23 – Uncertainty over Income Tax Treatments
- Long term Interests in Associates and Joint Ventures (Amendments to NZ IAS 28)
- Plan Amendment, Curtailment or Settlement (Amendments to NZ IAS 19)
- Annual Improvements to NZ IFRSs 2015-2017 Cycle
- RDR NZ IFRS 16 Leases and NZ IAS 7 Statement of Cash Flows
- Amendments to the Scope of FRS-42

NZ IFRS 16 Leases

In February 2016 the NZASB approved the issue of NZ IFRS 16 Leases.

Background

The new lease accounting standard provides much-improved transparency and comparability of companies' lease assets and lease liabilities for investors and other users of general purpose financial statements.

The standard eliminates the classification of leases as either operating leases or finance leases. Instead, there is a single lessee model which requires a lessee to recognise on the statement of financial position assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value.

Other matters to note about this replacement standard is that it:

- changes the definition of a lease;
- sets requirements on how to account for the asset and liability, including complexities such as non-lease elements, variable lease payments and option periods;
- provides exemptions for short-term leases and leases of low value assets;
- changes the accounting for sale and leaseback arrangements;
- requires more detailed disclosures;
- a range of transition options exists.

NZ IFRS 16 will not have any effect on the total amount of cash flows reported but it is expected to have an effect on the presentation of cash flows. This is because, applying NZ IAS 17 Leases, cash flows relating to operating leases are presented as cash flows from operating activities while applying NZ IFRS 16 will result in the presentation within financing activities of cash flows relating to the repayment of principal on lease liabilities.

NZ IFRS 16 Leases at a glance

Issues	Key points
Who is affected?	• Entities that lease assets as a lessee or a lessor;
What is the impact on lessees?	• All leases will be accounted for 'on-balance-sheet', other than short-term and low value asset leases; • Lease expense will typically be 'front-loaded'; • Lease liability will exclude: – option periods unless exercise is reasonably certain; – contingent payments that are linked to sales/usage and future changes in an index/rate;
What's the impact on lessors?	• Only minor changes from NZ IAS 17 as it currently stands;
Are there other changes?	• A new definition of a lease will result in some arrangements previously classified as leases ceasing to be so, and vice versa; • New guidance on sale and leaseback accounting; and • New and different disclosures.

Scope on NZ IFRS 16

NZ IFRS 16 applies to all leases for both, the lessee and lessor, except for a few scope solutions. These exclusions, some of which are similar to NZ IAS 17's, are summarised in the table below:

Scope exclusions from NZ IFRS 16

Scope exclusion	Standard to apply
Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources	None specified. Depending on the circumstances NZ IFRS 6 Exploration for and Evaluation of Mineral Resources or NZ IAS 38 Intangible Assets might apply
Leases of biological assets in scope of NZ IAS 41 held by a lessee	NZ IAS 41 Agriculture
Service concession arrangements in scope of NZ IFRIC 12	NZ IFRIC 12 Service Concession Arrangements
Licences of intellectual property granted by a lessor in scope of NZ IFRS 15	NZ IFRS 15 Revenue from Contracts with Customers
Rights held under licensing agreements in scope of NZ IAS 38 for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights*	NZ IAS 38 Intangible Assets

* for leases of other types of intangible asset a lessee is permitted to apply IFRS 16 but not required to do so.

Definition of a lease

Because the new lease accounting model brings many more leases 'on-balance sheet', the evaluation of whether a contract is (or contains) a lease becomes even more important than it is today.

Under NZ IFRS 16 a lease is defined as: 'a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration'. A contract is, or contains, a lease if:

- fulfilment of the contract depends on the use of an identified asset
- the contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.

In practice, the main impact of NZ IFRS 16's new definition and supporting guidance is likely to be on contracts that are not in the legal form of a lease but involve the use of a specific asset and may therefore contain a lease.

Lessee accounting

Subject to the optional accounting simplifications discussed below, a lessee will be required to recognise its leases on the balance sheet. This involves recognising:

- a 'right-of-use' asset; and
- a lease liability.

The lease liability is initially measured as the present value of future lease payments. For this purpose, lease payments include fixed, non-cancellable payments for lease elements, amounts due under residual value guarantees, certain types of contingent payments and amounts due during optional periods to the extent that extension is 'reasonably certain'.

In subsequent periods, the right-of-use asset is accounted for similarly to a purchased asset and depreciated or amortised. The lease liability is accounted for similarly to a financial liability using the effective interest method.

Optional accounting simplifications

NZ IFRS 16 provides important reliefs or exemptions for:

- short-term leases (a lease is short-term if it has a lease term of 12 months or less at the commencement date)
- low-value asset leases (the assessment of value is based on the absolute value of the leased asset when new and therefore requires judgement. In the Basis for Conclusions which accompanies the Standard, however, the IASB notes that they had in mind leases of assets with a value when new of around US $5,000 or less).

If these exemptions are used, the accounting is similar to operating lease accounting under the current Standard NZ IAS 17 Leases. Lease payments are recognised as an expense on a straight-line basis over the lease term or another systematic basis (if more representative of the pattern of the lessee's benefit).

Lessor accounting

NZ IFRS 16's requirements for lessor accounting are similar to NZ IAS 17's. In particular:

- the distinction between finance and operating leases is retained
- the definitions of each type of lease, and the supporting indicators of a finance lease, are substantially the same as NZ IAS 17's
- the basic accounting mechanics are also similar, but with some different or more explicit guidance in a few areas. These include variable payments; sub-leases; lease modifications; the treatment of initial direct costs; and lessor disclosures.

Sale and leaseback accounting

NZ IFRS 16 makes significant changes to sale and leaseback accounting.

If an entity (the seller-lessee) transfers an asset to another entity (the buyer-lessor) and leases that asset back from the buyer-lessor, both the seller-lessee and the buyer-lessor determine whether the transfer qualifies as a sale. This determination is based on the requirements for satisfying a performance obligation in NZ IFRS 15.

NZ IFRS 16 will require lessees to account for leases 'on-balance sheet' by recognising a 'right-of-use-asset' and a 'lease liability'.

Transition

In terms of transition, NZ IFRS 16 provides lessees with a choice between two broad methods:

- full retrospective application – with restatement of comparative information in accordance with NZ IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors; or
- partial retrospective application – without restating comparatives. Under this approach the cumulative effect of initially applying NZ IFRS 16 is recognised as an adjustment to equity at the date of initial application. If a lessee chooses this method, a number of more specific transition requirements and optional reliefs also apply.

Commercial significance

Most Number of entities affected

The new Standard, will requires lessees to account for leases 'on-balance sheet' by recognising a 'right of use' asset and a lease liability. It will affect most entities that report under NZ IFRS and are involved in leasing, and will have a substantial impact on the financial statements of lessees of property and high value equipment. For many other businesses, however, exemptions for short-term leases and leases of low value assets will reduce the impact.

High Impact on affected entities

In issuing this Standard compromises have been made to reduce the controversy of its introduction, in particular exemptions for short-term and low value asset leases. As a result entities that lease only assets such as printers and laptops will face only a limited impact. But for entities that lease 'big-ticket' assets, such as property and high-value equipment, this will be a major change.

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

In October 2017, the IASB published Prepayment Features with Negative Compensation (Amendments to IFRS 9) and the NZASB endorsed this and issued its equivalent in November 2017. The amendments allow companies to measure particular pre-payable financial assets with negative compensation at amortised cost or at fair value through other comprehensive income – instead of measuring those assets at fair value through profit or loss.

The amendments also include clarifications to the modification or exchange of a financial liability that does not result in derecognition.

After NZ IFRS 9 was issued, the IFRS Interpretations Committee received a request on how to apply the IFRS 9 requirements for recognising and measuring financial instruments to certain debt instruments where the borrower is permitted to prepay the instrument at an amount that could be less than the unpaid principal and interest owed. Such a prepayment feature is often referred to as including potential 'negative compensation'.

Under the then existing requirements of NZ IFRS 9, an entity would have measured a financial asset with negative compensation at fair value through profit or loss as the 'negative compensation' feature would have been viewed as introducing potential cash flows that were not solely payments of principal and interest.

However, to improve the usefulness of the information provided, in particular on the instrument's effective interest rate and expected credit losses, the NZASB issued the amendments so that entities will now be able to measure some pre-payable financial assets with negative compensation at amortised cost.

Commercial significance

Some — Number of entities affected

The amendments will have most relevance to financial institutions who hold these types of financial instruments, although it is possible that some other entities will be affected.

High — Impact on affected entities

The Prepayment Features with Negative Compensation is an important one as otherwise financial institutions would have had to account for what are essentially debt-type financial assets at fair value as opposed to amortised cost, which may not have provided the most useful information to users.

2017 Omnibus Amendments to NZ IFRS

The NZASB published Investments in Associates and Joint Ventures (Amendments to IAS 28) clarifying that the ultimate New Zealand parent shall apply the equity method in accounting for interests in associates and joint ventures unless the ultimate parent is an investment entity.

Also included in this set of amendments was a change to NZ IFRS 10 Consolidated Financial Statements that clarifies that the ultimate New Zealand parent is the entity that needs to prepare consolidated financial statements, unless the parent is an investment entity.

Commercial significance

Some

Number of entities affected

The amendments will impact entities that have interests in associates and joint ventures to which the equity method is applied.

Medium

Impact on affected entities

The amendment needs to be considered by entity's holdings in debt- type instruments issued by an associate or joint venture will be subject to NZ IFRS 9's impairment requirements.

NZ IFRIC 23 – Uncertainty over Income Tax Treatments

The IFRS Interpretations Committee (IFRIC) published a new Interpretation IFRIC 23 Uncertainty over Income Tax Treatments specifying how entities should reflect uncertainty in accounting for income taxes and the NZASB approved it for application in New Zealand as well for periods beginning on or after 1 January 2019.

NZ IAS 12 Income Taxes specifies how to account for current and deferred tax but not how to reflect the effects of uncertainty. NZ IFRIC 23 addresses this previous lack of guidance.

NZ IFRIC 23 addresses uncertainty over how tax treatments should affect the accounting for income taxes because IFRIC had observed that there was diversity in practice for various issues on the recognition and measurement of a tax liability or asset in circumstances where there is uncertainty in the application of the tax law in concern. The table below illustrates the main issues that are addressed by the Interpretation.

Main issues addressed by NZ IFRIC 23

Issue	Proposal
When and how the effect of uncertainty over income tax treatments should be included in the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates	• an entity is required to consider whether it is probable that a taxation authority will accept an uncertain tax treatment; • if it is, the entity would determine taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the tax treatment used or planned to be used in its income tax filings; • if the entity concludes that it is not probable that the taxation authority will accept an uncertain tax treatment, it uses either the most likely amount or the expected value in determining taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates (depending on which method is expected to better predict the resolution of the uncertainty).
The assumptions that an entity should make about the examination of tax treatments by taxation authorities	• an entity is required to assume that a tax authority will examine amounts it has a right to examine and will have full knowledge of all relevant information when making those examinations.
Changes in facts and circumstances	• entities are also required to reassess their judgements and estimates if facts and circumstances change (eg upon reaching a time limit where the taxation authority is no longer able to challenge an entity's tax treatments) or as a result of new information that affects the judgement or estimate becoming available.
Whether uncertain tax treatments should be considered separately	• entities would be required to use judgement to determine whether each uncertain tax treatment should be considered separately, or whether some uncertain tax treatments should be considered together. In determining the approach to be followed, entities shall consider which approach better predicts the resolution of the uncertainty.

Main issues addressed by NZ IFRIC 23

Issue	Proposal
Disclosure	• when addressing uncertainty over income tax treatments, entities are required to disclose judgements, assumptions and estimates made in accordance with the normal requirements of NZ IAS 1 Presentation of Financial Statements • in addition, if an entity concludes it is probable that a taxation authority will accept an uncertain tax treatment, it should consider whether to disclose the potential effect of the uncertainty as a tax-related contingency under NZ IAS 12 at paragraph 88.
Transition	• entities shall apply NZ IFRIC 23: – retrospectively by applying NZ IAS 8, if that is possible without the use of hindsight, or – retrospectively with the cumulative effect of initially applying the effect of the changes being recognised in the opening balance of retained earnings (or another component of equity) in the period of first application, without adjusting comparative information.

Commercial significance

Many

Number of entities affected

This Interpretation is applicable to any entity where there is uncertainty over whether a tax treatment will be accepted or disputed by the tax authorities. It includes all tax items (taxable profits and losses, tax bases, unused tax bases, unused tax credits and tax rates), and therefore could have a widespread impact.

Medium

Impact on affected entities

If an entity concludes there is uncertainty over the tax treatment of an item, it must account for the uncertain treatment accordingly. It could therefore have a significant impact on some entities depending on the item.

Long term Interests in Associates and Joint Ventures (Amendments to NZ IAS 28)

The NZASB published Investments in Associates and Joint Ventures (Amendments to IAS 28) clarifying that companies account for long-term interests in an associate or joint venture – to which the equity method is not applied – using NZ IFRS 9 Financial Instruments. This includes long-term interests that, in substance, form part of the entity's net investment in an associate or joint venture.

NZ IFRS 9 excludes interests in associates and joint ventures accounted for in accordance with NZ IAS 28. However, some stakeholders expressed an opinion that it was not clear whether that exclusion applies only to interests in associates and joint ventures to which the equity method is applied or whether it applies to all interests in associates and joint ventures.

In the amendments, the NZASB clarifies that the exclusion in NZ IFRS 9 applies only to interests accounted for using the equity method. Therefore, a company applies NZ IFRS 9 to other interests in associates and joint ventures, including long-term interests to which the equity method is not applied and which, in substance, form part of the net investment in those associates and joint ventures.

The IAS also published an example that illustrates how entities apply the requirements in IFRS 9 and NZ IAS 28 for long-term interests in an associate or joint venture.

Commercial significance

Some

Number of entities affected

The amendments will impact entities that have interests in associates and joint ventures to which the equity method is applied.

High

Impact on affected entities

The amendment is significant as it means holdings in debt-type instruments issued by an associate or joint venture will be subject to NZ IFRS 9's impairment requirements.

NZ IFRS 9 excludes interests in associates and joint ventures accounted for in accordance with NZ IAS 28.

Plan Amendment, Curtailment or Settlement (Amendments to NZ IAS 19)

NZ IAS 19 Employee Benefits requires an entity to remeasure its net defined benefit liability or asset when an amendment to, or a curtailment or settlement of a defined benefit plan takes place. However, NZ IAS 19 is not explicit on how to determine the expenses incurred after the change to the defined benefit plan has taken place.

In response, the NZASB published Plan Amendments, Curtailment or Settlement (Amendments to NZ IAS 19) following the IASB's publication of the same amendment to IAS 19. These require reporting entities to use updated actuarial assumptions to determine pension expenses following changes to a defined benefit pension plan.

More specifically, the amendments to NZ IAS 19 require that when a defined benefit plan is amended, curtailed or settled during a period and the net defined benefit liability or asset is remeasured as a result of one of these transactions, to:

- determine the current service costs and the net interest for the period after the remeasurement using the assumptions used for the remeasurement; and
- determine the net interest for the remaining period based on the remeasured net defined benefit liability or asset.

These amendments could change whether and when an entity remeasures its net defined benefit liability or asset. When assessing whether remeasuring the net defined benefit liability or asset will have a material impact, an entity will not only consider the effect on past service cost, or a gain or loss on settlement, but also the effects of using the updated assumptions for determining current service cost and net interest for the remainder of the annual reporting period after the plan amendment, curtailment or settlement.

Transition

The amendments are to be applied prospectively.

Commercial significance

Some Number of entities affected

The amendments will impact entities with defined benefit plans.

Medium Impact on affected entities

The amendments could change whether an entity remeasures its net defined benefit liability and the timing of this remeasurement.

Annual Improvements to NZ IFRSs 2015-2017 Cycle

The Annual Improvements to NZ IFRSs 2015-2017 Cycle includes the following narrow scope amendments.

Standard affected	Subject	Summary of amendment
NZ IFRS 3 Business Combinations and NZ IFRS 11 Joint Arrangements	Previously held interest in a joint operation	Paragraph 42A has been added to NZ IFRS 3 providing additional guidance on a business combination achieved in stages where the party to a joint arrangement obtains control of a business that is a joint operation. Paragraph B33CA has been added to NZ IFRS 11 on the accounting for acquisitions of interests in a joint operation.
NZ IAS 12 Income Taxes	Income tax consequences of payments on financial instruments classified as equity	Paragraphs 57A relating to the income tax consequences of dividends has been added and paragraph 52B is deleted. When an entity first applies the amendments, they shall be applied to the income tax consequences of dividends recognised on or after the beginning of the earliest comparative period.
NZ IAS 23 Borrowing costs	Borrowing costs eligible for capitalisation	Paragraph 14 is amended to state that an entity shall exclude from the capitalisation rate calculation, borrowing costs applicable to borrowings made specifically for the purpose of obtaining a qualifying asset until substantially all the activities necessary to prepare that asset for its intended use or sale are complete. The amendment shall be applied to borrowing costs incurred on or after the beginning of the annual reporting period in which the entity first applies the amendments.

Commercial significance

Few

Number of entities affected

Only a few entities are likely to be affected.

Low

Impact on affected entities

The NZASB's Annual Improvements process addresses non-urgent, but necessary minor amendments to NZ IFRSs. By their nature then, their commercial significance can be expected to be low and overall the changes are largely uncontroversial.

RDR NZ IFRS 16 and NZ IAS 7

Amendments to RDR NZ IFRS 16 Leases and NZ IAS 7 Statement of Cash Flows was issued in July 2018 by the NZASB and contains disclosure concessions for Tier 2 for-profit entities applying NZ IFRS 16 Leases and NZ IAS 7 Statement of Cash Flows.

Commercial significance

Some

Number of entities affected

Some entities are likely to be affected.

Low

Impact on affected entities

The changes reduce the current losses of disclosure being made.

Amendments to the scope of FRS-42

In May 2018, the NZASB issued amendments to the scope of FRS-42 Prospective Financial Statements so that it applies only to an entity that is required by legislation or regulation to present general purpose prospective financial statements in accordance with generally accepted accounting practice (GAAP) in New Zealand. As part of clarifying the scope of FRS-42, references to prospective financial information have also been removed.

Commercial significance

Some

Number of entities affected

The entities affected are most likely required to report this information under regulatory requirements.

Low

Impact on affected entities

The change now clarifies with precision what now needs to be disclosed.

Effective from 1 January 2020

The amendments discussed below are effective for accounting periods beginning on or after 1 January 2020:

- Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to NZ IFRS 10 and NZ IAS 28)
- Definition of Material (Amendments to NZ IAS 1 and NZ IAS 8)
- Definition of Material (Amendments to Conceptual Frameworks)
- New Zealand Equivalent to the IASB Conceptual Framework for Financial Reporting (2018 NZ Conceptual Framework)
- Definition of a Business (Amendments to NZ IFRS 3)

Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to NZ IFRS 10 and NZ IAS 28)

Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to NZ IFRS 10 and NZ IAS 28) and Effective Date of Amendments to NZ IFRS 10 and NZ IAS 28

The following section describes the Amendment to IFRS 10 and IAS 28 Sale of Contribution of Assets between an Investor and its Associate or Joint Venture issued by the IASB that was subsequently endorsed by the NZASB in October 2014 by issuing Sale or Contribution of Assets Between an Investor and its Associate or Joint Venture (Amendments to NZ IFRS 10 and NZ IAS 28).

The original effective date of the Amendments to NZ IFRS 10 and NZ IAS 28 was for annual reporting periods beginning on or after 1 January 2016, however, in February 2016, the NZASB issued Effective Date of Amendments to NZ IFRS 10 and NZ IAS 28 which defer the mandatory effective date of the New Zealand amendments to annual reporting periods beginning on or after 1 January 2020. Note that this effective date differs from the IASB who have indefinitely deferred the mandatory effective date of their equivalent amendment until the completion of their research project on the equity method of accounting. The NZASB determined that the 2020 effective date would satisfy New Zealand's legislative requirements whilst providing an appropriate period for the IASB to complete its equity accounting project.

The following section outlines the background to the amendment.

The amendments to NZ IFRS 10 and NZ IAS 28 addresses an acknowledged inconsistency between NZ IFRS 10 Consolidated Financial Statements and NZ IAS 28 (2011) Investments in Associates. This relates to accounting for transactions in which a parent entity loses control of a subsidiary by contributing it to an associate or joint venture.

The inconsistency stemmed originally from a conflict between the requirements of NZ IAS 27 Consolidated and Separate Financial Statements (Revised 2008) and NZ SIC-13 Jointly Controlled Entities – Non-Monetary Contributions by Venturers. While NZ IAS 27 required the full gain or loss to be recognised on the loss of control of a subsidiary, NZ SIC-13 required a partial gain or loss recognition in transactions between an investor and its associate or joint venture. Although NZ IFRS 10 supersedes NZ IAS 27, and NZ IAS 28 (2011) supersedes both NZ IAS 28 and NZ SIC-13, the conflict remained.

The amendments now alter NZ IFRS 10 so that:

- the current requirements for the partial gain or loss recognition for transactions between an investor and its associate or joint venture only apply to the gain or loss resulting from the sale or contribution of assets that do not constitute a business, as defined in NZ IFRS 3; and
- the gain or loss from the sale or contribution of assets that constitute a business between an investor and its associate or joint venture is recognised in full.

Corresponding amendments have been made to NZ IAS 28 (2011) to reflect these changes. In addition NZ IAS 28 (2011) has been amended to clarify that when determining whether assets that are sold or contributed constitute a business, an entity shall consider whether the sale or contribution of those assets is part of multiple arrangements that should be accounted for as a single transaction.

Commercial significance

Few — Number of entities affected

The scope of the amendments are narrow in nature.

Medium — Impact on affected entities

The amendments offer a pragmatic solution to a well-known. conflict between NZ FRS 10 and NZ IAS 28.

The Amendments to NZ IFRS 10 and NZ IAS 28 address an acknowledged inconsistency between NZ IFRS 10 'Consolidated Financial Statements' and IAS 28 (2011) 'Investments in Associates'. They can still be applied even though the effective date of the amendments has been deferred indefinitely.

Definition of Material (Amendments to NZ IAS 1 and NZ IAS 8)

The NZASB issued Definition of Material making amendments to NZ IAS 1 Presentation of Financial Statements and NZ IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, following the publication of equivalent amendments to IAS 1 and IAS 8 by the IASB.

The amendments are a response to findings that some companies experienced difficulties using the previous definition of materiality when judging whether information was material for inclusion in the financial statements. In fact, up to now, the wording of the definition of material in the Conceptual Framework for Financial Reporting differed from the wording used in NZ IAS 1 and NZ IAS 8. The existence of more than one definition of material was potentially confusing, leading to questions over whether the definitions had different meanings or should be applied differently.

The old definition
Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements.

The new definition
Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

Grant Thornton insight – 'obscuring'
Including 'obscuring' in the definition of material addresses concerns that the former definition could be perceived by stakeholders as focusing only on information that cannot be omitted (material information) and not also on why it may be unhelpful to include immaterial information. However, this does not mean that entities are prohibited from disclosing immaterial information.

The amendments give a number of examples of circumstances that may result in material information being obscured.

Grant Thornton insight – 'reasonably be'
This wording reflects wording previously used in NZ IAS 1 and helps to address concerns raised by some parties that the threshold 'could influence' in the existing definition of material is too low and might be applied too broadly.

Grant Thornton insight – 'primary users'
The amendments note that many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial statements for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial statements are directed.

The amendments are designed to rectify this problem and make it easier for companies to define materiality judgements. They do this by:

- including in the definition guidance that until now has featured elsewhere in NZ IFRS;
- improving the explanations that accompany the definition, and
- ensuring that the definition of material is consistent across all NZ IFRS.

Commercial significance

Most

Number of entities affected

The concept of materiality is used by most entities.

Few

Impact on affected entities

The amendments are intended to make the definition easier to understand and are not intended to alter the concept of materiality in NZ IFRS. As such, we do not expect the amendments to change significantly how materiality judgements are made in practice or to significantly affect entities' financial statements. We do however expect that they will improve the understanding of this important area.

Definition of Material (Amendments to Conceptual Frameworks)

This amendment amends the description of materiality in the New Zealand Equivalent to the IASB Conceptual Framework for Financial Reporting 2010 (NZ Framework) and the New Zealand Equivalent to the IASB Conceptual Framework for Financial Reporting (2018 NZ Conceptual Framework). The amendments arose as a consequence of the amendments to the definition of material in NZ IAS 1 Presentation of Financial Statements and NZ IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, as set out in Definition of Material (Amendments to NZ IAS 1 and NZ IAS 8) (see previous section).

In addition to the new definition outlined in the previous section, the amendments to the Conceptual Frameworks outline that as materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report, a uniform quantitative threshold for materiality or predetermined materiality, cannot be prescribed in a particular situation.

Commercial significance

Most

Number of entities affected

The concept of materiality is used by most entities.

Few

Impact on affected entities

The amendments are intended to make the definition easier to understand and are not intended to alter the concept of materiality in NZ IFRS. As such, we do not expect the amendments to change significantly how materiality judgements are made in practice or to significantly affect entities' financial statements. We do however expect that they will improve the understanding of this important area.

2018 NZ Conceptual Framework

The following section outlines the development of the IASB's revised Conceptual Framework, which has been endorsed by the NZASB through the publication of the New Zealand Equivalent to the IASB Conceptual Framework for Financial Reporting (2018 NZ Conceptual Framework).

In March 2018, the IASB published a revised 'Conceptual Framework for Financial Reporting' (Conceptual Framework) concluding its long-running project in this area. Although it is not a Standard and will not immediately change or override any existing Standards, it may affect entities that develop or select accounting policies in accordance with the previous version of the Conceptual Framework that was issued in 2010.

Background

The Conceptual Framework describes the objective of, and the concepts for, general purpose financial reporting. It is mainly a tool for the IASB to develop and revise Standards that are based on consistent concepts, but entities might also use it when they have to develop accounting policies when no Standard applies or when a Standard allows a choice of accounting policy.

The original Conceptual Framework was issued in 1989 and was updated on several occasions, the last being in 2010. The 2010 version included two revised chapters on the objective of financial reporting and the qualitative characteristics of useful financial information but, for example, did not contain a chapter on the reporting entity or guidance on measurement or reporting financial performance. In addition to lacking guidance in certain areas, some existing guidance was not as clear as desired or was outdated.

A public consultation on the IASB's workplan in 2012 therefore highlighted the need for a revision of the 2010 Conceptual Framework and in an effort to make the Conceptual Framework a complete and overarching set of concepts, the project was added to the IASB's agenda. Before issuing a revised Conceptual Framework in 2018, the IASB sought input by publishing a Discussion Paper in 2013 and an Exposure Draft in 2015.

Main issues addressed by the revised Conceptual Framework

The revised Conceptual Framework now sets out a more complete set of concepts in eight chapters:

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

The guidance on measurement, financial performance, derecognition, and the reporting entity is new to the Conceptual Framework. In addition, some of the existing guidance was updated. For example, the IASB has reintroduced the concept of prudence to support a faithful representation and clarified that measurement uncertainty can impact a faithful representation.

The revised Conceptual Framework also updates some existing concepts like the definitions of assets and liabilities. Although both definitions worked well in the past, the revised definitions now focus more on describing an asset as an economic resource and a liability as an obligation to transfer an economic resource rather than describing both in terms of a flow of benefits.

Consequential amendments and effects on preparers

Alongside the revised Conceptual Framework, the IASB has published Amendments to References to the Conceptual Framework in IFRS Standards. This publication updates nearly all of the references to previous versions with references to the 2018 Conceptual Framework. The IASB is confident that the updated references will have no impact on preparers of financial statements and reminds them, that the Conceptual Framework is not a Standard and does not change or override requirements of any existing Standards.

However, some references have not been updated or allow preparers to continue applying the 2010 Conceptual Framework. To avoid unintended consequences, preparers are required to apply the definitions of assets and liabilities from the 2010 Conceptual Framework when accounting for business combinations under IFRS 3. The IASB plans to explore in due course how those references can be updated without having any effects on preparers of financial statements.

Also, preparers will continue using the 2010 definitions of assets and liabilities when accounting for regulatory account balances. This means preparers will not have to change their accounting for rate-regulated assets and liabilities twice within a short period of time as the IASB is planning to replace the interim Standard IFRS 14 'Regulatory Deferral Accounts' in the near future.

Transition

Whilst the Conceptual Framework is not a Standard and will not change or override any existing Standards, entities that develop accounting policies using the Conceptual Framework, or that are in any other way affected by the amendments to IFRS Standards, will have to apply the changes from 1 January 2020.

Commercial significance

Most

Number of entities affected

The concept of materiality is used by most entities.

Few

Impact on affected entities

The amendments are intended to make the definition easier to understand and are not intended to alter the concept of materiality in IFRS. As such, we do not expect the amendments to change significantly how materiality judgements are made in practice or to significantly affect entities' financial statements. We do however expect that they will improve the understanding of this important area.

Definition of a business (Amendments to NZ IFRS 3)

In December 2018, the NZASB issued Definition of a Business making amendments to NZ IFRS 3 Business Combinations, following the IASB's publication of the same amendment to IFRS 3 Business Combinations.

The amendments are a response to feedback received from the IASB's post-implementation review of IFRS 3. They clarify the definition of a business, with the aim of helping entities to determine whether a transaction should be accounted for as an asset acquisition or a business combination.

The amendments:

- clarify the minimum attributes that the acquired assets and activities must have to be considered a business;
- remove the assessment of whether market participants can acquire the business and replace missing inputs or processes to enable them to continue to produce outputs;
- narrow the definition of a business and the definition of outputs; and
- add an optional concentration test that allows a simplified assessment of whether an acquired set of activities and assets is not a business.

New definition of a business

An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.

What are the minimum requirements to meet the definition of a business?

The amendments acknowledge that despite most businesses having outputs, outputs are not necessary for an integrated set of assets and activities to qualify as a business. In order to meet the definition of a business the acquired set of activities and assets must have inputs and substantive processes that can collectively significantly contribute to the creation of outputs.

Is the acquired process substantive?

The amendments add guidance and illustrative examples to assist entities in assessing whether a substantive process has been acquired. The guidance explains that those entities that do not have outputs are new entities that have not yet generated revenue. If the acquired set of activities and assets is generating revenue at the acquisition date it is considered to have outputs.

For activities and assets that do not have outputs at the acquisition date, the acquired process is substantive if:

- it is critical to being able to develop or convert an acquired input into an output the inputs acquired include both:
  - an organised workforce that has the skills, knowledge or experience to perform the process; and
  - other inputs that the organised workforce could develop or convert into outputs (e.g. Technology, in-process research and development projects, real estate and mineral interests).

For activities and assets that have outputs at the acquisition date, the acquired process is substantive if:

- it is necessary to being able to continue to produce outputs, and the acquired inputs include an organised workforce with the necessary skills, knowledge or experience to perform the process; and
- it significantly contributes to being able to continue producing outputs and is deemed to be unique or scarce or it cannot be replaced without significant cost, effort or delay in producing outputs.

How have the amendments changed the definition?

The amendments replace the wording in the definition of a business from:

- 'providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants' to
- 'providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.'

This narrows the definition by focussing on goods or services rather than returns.

What is the optional concentration test?

The amendments introduce an optional test (the concentration test) that allows the acquirer to carry out a simple assessment to determine whether the set of activities and assets acquired is not a business. If the test is successful, then the set of activities and assets acquired is not a business and no further assessment is required. If the test is not met or the entity does not carry out the test, then the entity needs to assess whether or not the acquired set of assets and activities meets the definition of a business in the normal way.

The test is met if substantially all of the fair value of the gross assets acquired is concentrated in one or a group of similar identifiable assets. Gross assets exclude cash and cash equivalents, deferred tax assets and goodwill from the effects of deferred tax liabilities. The amendments also provide guidance on what a single identifiable asset or a group of similar identifiable assets would be.

Asset purchase versus business combination

It is important to distinguish business combinations from asset purchases because the IFRS requirements are very different. Some of the key differences are summarised in the table below.

Accounting topic	Business combination	Asset purchase
Recognition of identifiable assets and liabilities	• measured at fair value	• total cost is allocated to individual items based on relative fair values
Goodwill or gain on bargain purchase	• recognised as an asset (goodwill) or as income (gain or bargain purchase)	• not recognised
Transaction costs	• expensed when incurred	• typically capitalised
Deferred tax on initial temporary differences	• recognised as assets and liabilities	• not recognised unless specific circumstances apply

Transition

The amendments are to be applied prospectively to business combinations and asset acquisitions for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020. Entities can apply the amendments earlier if they disclose this fact.

Commercial significance

Some

Number of entities affected

The amendments could impact all business combinations and purchases where it is unclear whether an asset or a business has been acquired.

Medium

Impact on affected entities

The impact could be significant if the outcome as to whether there is a business changes.

Effective from 1 January 2021

The following Standard is currently effective for accounting periods beginning on or after 1 January 2021:

- NZ IFRS 17 Insurance Contracts

NZ IFRS 17 Insurance Contracts

The Standard discussed below is effective for accounting periods beginning on or after 1 January 2021.[1]

Background

After twenty years of development, the IASB has published IFRS 17 Insurance Contracts which the NZASB endorsed in August 2017. This represents a record in terms of development period, the lengthy completion period reflecting a number of factors including:

- very diverse local practices for insurance accounting
- a huge range of jurisdiction-specific products, tax implications and regulations that had to be captured by a uniform measurement model
- the need for alignment with other Standards that have been recently published by the IASB, such as IFRS 9 'Financial Instruments' and IFRS 15 'Revenue from Contracts with Customers', and to some degree the work of other standard setters.

The new Standard replaces NZ IFRS 4 Insurance Contracts which was published in 2004. NZ IFRS 4 was designed to be an interim Standard and therefore allowed entities issuing insurance contracts to carry on accounting for them using policies that had been developed under their previous local accounting standards. This meant that entities continued to use a multitude of different approaches for accounting for insurance contracts, making it difficult to compare and contrast the financial performance of otherwise similar entities.

Scope

NZ IFRS 17 applies to all insurance contracts that an entity issues, reinsurance contracts it holds; and investment contracts with a discretionary participation feature, provided the entity also issues insurance contracts.

NZ IFRS 17 defines an insurance contract as one under which one party (the issuer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

This definition is similar to that in NZ IFRS 4. In addition, NZ IFRS 17 provides guidance on how to assess the significance of insurance risk based on the possibility of a loss on a present value basis (rather than nominal), and how to evaluate changes in the level of insurance risk.

[1]At the time of the publication, both the IASB and the NZASB are contemplating delaying the effective date of this standard by one year to 1 January 2022.

Measurement

NZ IFRS 17 requires an entity that issues insurance contracts to report them on the statement of financial position as the total of:

- the fulfilment cash flows – the current estimates of amounts that the insurer expects to collect from premiums; and
- the pay out for claims, benefits and expenses, including an adjustment for the timing and risk of those cash flows and the contractual service margin – the expected profit for providing future insurance coverage (ie unearned profit).

The measurement of the fulfilment cash flows reflects the current value of any interest rate guarantees and financial options included in the insurance contracts.

To better reflect changes in insurance obligations and risks, NZ IFRS 17 requires an entity to update the fulfilment cash flows at each reporting date, using current estimates that are consistent with relevant market information. This means that insurance obligations will be accounted for using current values instead of historical cost, ending the practice of using data from when a policy was taken out.

Current discount rates are also required to be used. These will reflect the characteristics of the cash flows arising from the insurance contract liabilities, a change from the previous situation where many entities used discount rates based on the expected return on assets backing the insurance contract liabilities.

Revenue is no longer equal to written premiums but to the change in the contract liability covered by the consideration.

Insurance performance

NZ IFRS 17 requires an entity to provide information that distinguishes two ways insurers earn profits from insurance contracts:

- the insurance service result, which depicts the profit earned from providing insurance coverage;
- the financial result, which captures:
  - investment income from managing financial assets;
  - insurance finance expenses from insurance obligations – the effects of discount rates and other financial variables on the value of insurance obligations.

When applying NZ IFRS 17, changes in the estimates of the expected premiums and payments that relate to future insurance coverage will adjust the expected profit – ie the contractual service margin for a group of insurance contracts will be increased or decreased by the effect of those changes.

The effect of such changes in estimates will then be recognised in profit or loss over the remaining coverage period as the contractual service margin is earned by providing insurance coverage.

Onerous contracts

To make differences in profitability among insurance contracts visible, NZ IFRS 17 requires an entity to distinguish groups of contracts expected to be loss-making from other contracts.

Companies should first identify portfolios of insurance contracts that are subject to similar risks and managed together. Once an entity has identified portfolios of contracts, it divides each portfolio into groups considering differences in the expected profitability of the contracts.

If the amounts that the insurer expects to pay out on a contract in the form of claims, benefits and expenses exceed the amounts that the insurer expects to collect from premiums, either at the inception of the contracts or subsequently, the contracts are loss making and the difference will be recognised immediately in profit or loss.

Reinsurance contracts

A separate measurement model applies to reinsurance contracts held. Modifications are allowed for qualifying short- term contracts and participating contracts.

NZ IFRS 17 solves the comparison problems created by NZ IFRS 4 by requiring all insurance contracts to be accounted for in a consistent manner, benefiting both the investors and insurance companies.

Presentation

Statement of financial position

The statement of financial position should present in separate captions the assets and liabilities arising under insurance contracts issued and reinsurance contracts held.

In contrast to practices existing under various local GAAPs, entities should adopt a grossed-up presentation where contracts, which are assets, are not netted off against contracts, which are liabilities and vice versa. NZ IFRS 17 does not mandate a layout for the statement of financial position. The reporting entities should follow the general requirements of NZ IAS 1 Presentation of Financial Statements but need to ensure that certain captions are presented as a minimum on the face of the statement.

Statement of financial performance – measurement of revenue and expenses

NZ IFRS 17 does not mandate a layout for the statement of financial performance. Reporting entities should follow the principle requirements of NZ IAS 1 and the measurement rules of NZ IFRS 17, which require that revenue and incurred expenses presented in profit or loss exclude any investment components.

Measurement of insurance contract revenue

Revenue recognition is an area where NZ IFRS 17 principles represent a significant change from practices previously followed in various local GAAPs. Previously revenue was reported by reference to premium cash received or receivable.

Under NZ IFRS 17, revenue represents the total change in the liability for remaining coverage that relates to coverage and services during the period for which the entity expects to receive consideration.

Supporting materials issued by the IASB

Following publication of NZ IFRS 17, the IASB has announced various initiatives to support entities with the adoption of the Standard, including a dedicated implementation support page for NZ IFRS 17 and a webinar on the Standard.

The IASB has now established a Transition Resource Group which will discuss questions from stakeholders about the new accounting requirements.

Disclosure

The objective of the disclosure requirements of NZ IFRS 17 is to disclose information which allows the users of financial statements to assess the effect that contracts within the scope of the Standard have on the entity's financial position, financial performance and cash flows. Entities should provide quantitative and qualitative information about amounts recognised in the financial statements, significant judgements (and changes thereof), and the nature and extent of risks arising from contracts within the scope of the Standard.

Reporting entities are required to follow NZ IAS 1's requirements on materiality and aggregation when deciding what aggregation bases are appropriate for disclosure. The type of contract, geographical area or reportable segment as defined in NZ IFRS 8 Operating Segments are all examples suggested but not mandated by the Standard.

Transition

NZ IFRS 17 has an effective date of 1 January 2021 but may be applied earlier provided the entity applies NZ IFRS 9 Financial Instruments and NZ IFRS 15 Revenue from Contracts with Customers at or before the date of initial application of the Standard.

In 2016, the IASB made narrow scope amendments to NZ IFRS 4 Insurance Contracts to provide temporary accounting solutions for the practical challenges of implementing NZ IFRS 9 before NZ IFRS 17.

At the time of writing, the IASB is considering deferring the effective date of IFRS 17. Subject to public consultation, they are proposing to defer it by one year. If so, the deferral will likely be endorsed by the NZASB.

Commercial significance

Some

Number of entities affected

NZ IFRS 17 is a Standard about insurance contracts, not a Standard for the insurance industry. While insurance companies will be most affected, its effect will also be felt beyond the entities authorised to carry out regulated (re) insurance activities in a jurisdiction.

High

Impact on affected entities

NZ IFRS 17 fundamentally changes the accounting for insurance contracts. It will have a substantial impact on the financial statements of those with insurance contracts. Presently there is a huge diversity in the way insurance contracts are accounted for, NZ IFRS 17 is set to make consistent these accounting practices and will transform data, people, technology solutions and investor relations. Implementation costs are likely to be high as entities get to grips with the new Standard.

No effective date

The following Practice Statement has been postponed indefinitely:

- Practice Statement 2 – Making material judgements

Practice Statement 2 – Making material judgements

In September 2017, the IASB published its second IFRS Practice Statement - Making Materiality Judgements (the 'Practice Statement'). The Practice Statement encourages entities to apply judgement so that financial statements focus on the information that is useful to investors rather than trying to comply with an IFRS 'checklist'. This non-authoritative guidance, which can be applied immediately, marks the next step in the IASB's ongoing 'Disclosure Initiative'.

The concept of materiality is important in the preparation of financial statements, because it helps companies determine which information to include or exclude from their reports. he 'Conceptual Framework for Financial Reporting' discusses materiality as follows:

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

However, management is often faced with uncertainty in applying that concept. Such uncertainty is encountered when making decisions about recognition and measurement but most of all when deciding what information to disclose in the notes and how to present that information.

This uncertainty has led to some entities using the disclosure requirements in IFRS Standards as a checklist rather than judging which information would be most useful to investors and other stakeholders.

In publishing the Practice Statement, the IASB is providing support to companies when making materiality judgements and in doing so hopes to encourage behavioural change.

The Practice Statement gathers all the materiality requirements in IFRS Standards and adds practical guidance and examples entities may find helpful in deciding whether information is material.

The Practice Statement sets out a four-step process to making decisions on materiality:

Four-step process to making decisions on materiality

Issue	Proposal
Step 1 – Identify	• Identify information that has the potential to be material.
Step 2 – Assess	• Assess whether the information identified in Step 1 is, in fact, material.
Step 3 – Organise	• Organise the information within the draft financial statements in a way that communicates the information clearly and concisely to primary users.
Step 4 – Review	• Review the draft financial statements to determine whether all material information has been identified and materiality considered from a wide perspective and in aggregate, on the basis of the complete set of financial statements.

The Practice Statement also gives guidance on specific topics such as:

- prior-period information
- errors
- information about covenants
- materiality judgements for interim reporting.

The Practice Statement is not a Standard and its application is not mandatory or required in order to state compliance with IFRS. It does not change existing requirements or introduce new ones. Instead, it aims to provide guidance to assist management in applying the concept of materiality when preparing their financial statements. The guidance in the Practice Statement can be applied from its date of publication which was 14 September 2017.

The Practice Statement encourages entities to apply judgement so that financial statements focus on the information that is useful to investors rather than trying to comply with an IFRS 'checklist'.

Commercial significance

Many

Number of entities affected

Many companies face uncertainty in applying the concept of materiality in the preparation of financial statements so this Practice Statement will be useful to the majority of companies.

Medium

Impact on affected entities

The Practice Statement provides principle based guidance which, if applied, may or may not impact the materiality decision. The Practice Statement provides non-mandatory guidance, which does not have the same authority as a Standard approved by the NZASB.

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