Insights into Accounting and Financial Reporting

For-profit entities applying NZ IFRS

November 2023

Agenda

Simon Lee

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Standard Setting Update

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Emissions and green schemes

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Senior Manager

Impairment of non-financial assets and identifying CGUs

Agenda

01

New standards, amendments and IFRIC agenda decisions

02

Emissions and green schemes

03

Impairment of non-financial assets and identifying CGUs

New standards, amendments and IFRIC decisions

Agenda

01 Amendments effective for periods beginning on or after 1 January 2023

02 Amendments effective for periods beginning on or after 1 January 2024

03 Recent published IFRIC agenda decisions

Standards and Amendments effective for periods beginning on or after 1 January 2023

Standard	Amendment
Amendments to NZ IAS 8 *Accounting Policies, Changes in Estimates and Errors*	Definition of Accounting Estimates
Amendments to NZ IAS 1 *Presentation of Financial Statements* and IFRS Practice Statement 2	Disclosure of Accounting Policies
Amendments to NZ IAS 12 *Income Taxes*	Deferred tax related to assets and liabilities from a single transaction
Amendments to NZ IAS 12 *Income Taxes* *Effective 23 May 2023 (IFRS), 10 August 2023 (NZ IFRS)	Amendments to NZ IAS 12 – International Tax Reform – Pillar Two Model Rules*
NZ IFRS 17 Insurance Contracts	New standard

Accounting policy or estimate?

Definition of Accounting Estimates

NZ IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*

Effective from 1 January 2023

Accounting policy

Retrospective
(Restatement required)

?

Accounting estimate

Prospective
(No restatement)

Different outcomes

Diversity in practice

The term '**accounting estimates**' was not defined

Unclear definition of a change in accounting estimate

Accounting estimates

Definition of Accounting Estimates – NEW

Accounting estimates are monetary amounts in financial statements that are subject to measurement uncertainty

Definition of Accounting Policies – UNCHANGED

Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing a presenting financial statements.

NZ IAS 8.35 - UNCHANGED

When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.

Disclose ‘material’ accounting policies

Disclosure of Accounting Policies

NZ IAS 1, *Presentation of financial Statements*

Effective from 1 January 2023

More relevant and less cluttered

Is the transaction, other event or condition material? (Step 1)

No → **No accounting policy information needs to be disclosed**

Yes → **Is the related accounting policy information itself material? (Step 2)**

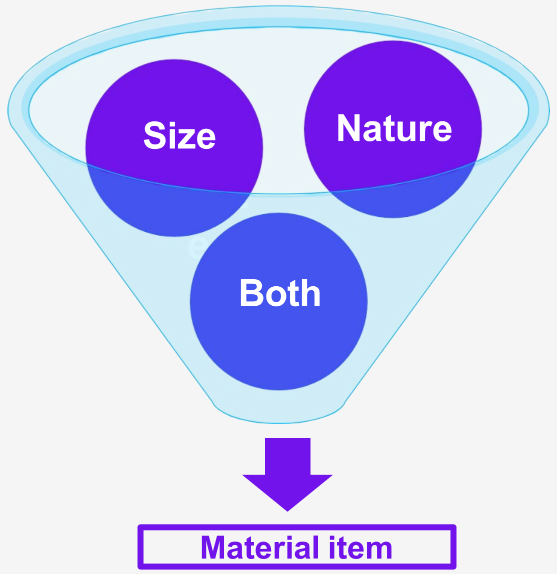
No → **No accounting policy information needs to be disclosed**

Yes → **Disclose material accounting policy information**

No accounting policy information needs to be disclosed → **Disclose material accounting policy information**

Disclose material accounting policy information → Go to Step 3 → **Determine what accounting policy information to disclose (step 3)**

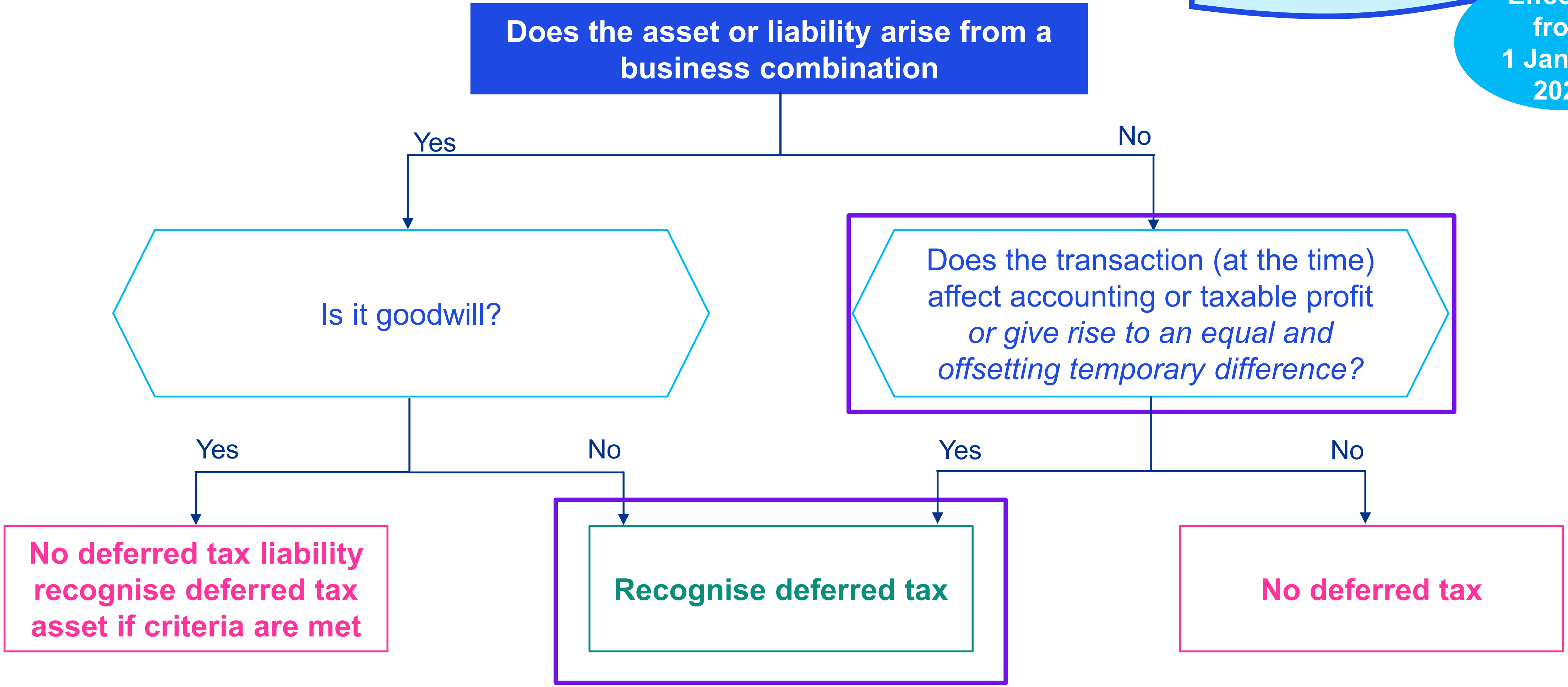
Assessing materiality



Deferred tax – Initial recognition exemption

Deferred Tax related to Assets and Liabilities arising from a Single Transaction [NZ IAS 12]

Effective from 1 January 2023



Deferred tax related to assets & liabilities arising from a single transaction

Scenario

- On 1 Jan 2018 Co. A enters into a 10-year lease of a building and recognised a ROU asset and lease liability of $100m (DR ROU asset; CR Lease liability)
- Co. A previously applied the IRE and recognised no deferred taxes on leases
- Co. A adopts amendments in their 31 Dec 2023 financial report
- Tax rate is 28%
- ROU asset and lease liability at the relevant dates:

	ROU asset	Lease Liability
1 Jan 2018	100	(100)
1 Jan 2022	**60**	**(69)**
1 Jan 2023	50	(60)
1 Dec 2023	40	(50)

Q1: What are the temporary differences to be recognised on transition (i.e. 1 Jan 2022)?

	Carrying amount	Tax Base	Deductible (Taxable) TD	DTA (DTL) @ 28%
ROU Asset	60	0	(60)	(16.8)
Lease Liability	(69)	0	69	19.3

Q2: What is the journal entry to be recorded on transition?

DR Deferred tax asset	$19.3m	
CR Deferred tax liability		$16.8m
CR Retained earnings		$2.5m

International Tax Reform – Pillar Two Model

WHY	To address concerns about uneven profit distribution
WHO	Multinational Enterprises (MNE) > **EUR750 million** (approx. NZD$1.3b) of global turnover in 2 of last 4 years (excludes govt, NFP, pensions, investment funds)
WHAT	**A global minimum tax of 15%** for each jurisdiction that a multinational group (MNE) operates (based on aggregate results of all entities in that jurisdiction)
HOW	• If **jurisdiction aggregate effective tax rate < 15%** then **top up tax** generally **payable** by ultimate parent on behalf of low tax jurisdiction • **Highly complex** calculation involving tax and accounting inputs

Amendments to IAS 12: Pillar Two income taxes – what's the issue?

Do Pillar Two taxes create additional temporary differences?

Are existing deferred taxes remeasured to reflect potential top-up tax payable?

Which tax rate is used to measure deferred taxes?

Amendments to NZ IAS 12: International Tax Reform – Pillar Two Model Rules

Effective immediately retrospectively from 10 August 2023

Amendment:
An entity shall neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes

Disclosure:

If the entity has applied exception to recognising and disclosing information about deferred tax assets and liabilities related to Pillar 2.

IFRS – effective immediately from May 2023

Effective periods beginning on or after 1 January 2023

Disclosures:

Separately disclose current income tax expense related to Pillar 2 income taxes

Known or reasonably estimable information that helps users of financial statements understand the entity's exposure to Pillar Two income taxes. This should be both quantitative and qualitative.

Amendments to IAS 12: International Tax Reform – Pillar Two Model Rules

J. Global minimum top-up tax[a, b, c]

The Group operates in [*Country K*], which has enacted new legislation to implement the global minimum top-up tax. The Group expects to be subject to the top-up tax in relation to its operations in [*Country F*], where the statutory tax rate is 10 percent, and in [*Country G*], where Subsidiary X receives government support through additional tax deductions that reduce its effective tax rate to below 15 percent. However, since the newly enacted tax legislation in [*Country K*] is only effective from 1 January 2024, there is no current tax impact for the year ended 31 December 2023.

The Group has applied a temporary mandatory relief from deferred tax accounting for the impacts of the top-up tax and accounts for it as a current tax when it is incurred (see Note 5(B)).

If the top-up tax had applied in 2023, then the profits relating to the Group's operations in [*Country F and Country G*] for the year ended 31 December 2023 that would be subject to it amount to EUR 375 thousand, with the average effective tax rate applicable to those profits during 2023 being 12 percent.[a, b, c]

NZ IFRS 17 Insurance Contracts (non-insurers)

Do you have an insurance contract?

Insurance risk is any risk, other than financial risk, transferred from the holder to the issuer of a contract

Is there a contract?

Yes

Is the issuer agreeing to compensate the counterparty for a specified uncertain future event?

Yes

Does the specified uncertain future event adversely affect the counterparty?

Yes

Is significant insurance risk transferred from the counterparty?

Yes

NZ IFRS 17 **may** apply

No → **NZ IFRS 17 does not apply**

Do you have an insurance contract?

- Entity L sells annual breakdown contracts for equipment.
- In the 1st year, fees for these services are fixed.
- In subsequent years, these services are repriced based on:
  - The frequency of call outs by the customer and
  - The age of the individual piece of equipment

Is this an insurance contract?

a. Yes

b. No

✓ Is there a contract?

✓ Compensating the policyholder for an uncertain future event?

✓ Event adversely affecting the policyholder?

✓ Transfer of insurance risk?

This is an insurance contract

This is only the first step!

The second step is considering NZ IFRS 17's scope exceptions.

Some fixed-fee service contracts are insurance contracts

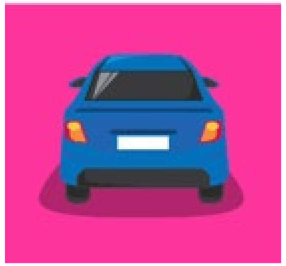
Are all the following conditions met?

1. The entity **does not reflect** an assessment of the risk associated with an **individual customer** in setting the price of the contract with that customer
2. The contract compensates the customer by **providing services**, rather than by making cash payments to the customer
3. The insurance risk transferred by the contract arises primarily from the **customer's use of services** rather than from uncertainty over the cost of those services

Yes → Chose to apply NZ IFRS 15 or NZ IFRS 17 contract by contract

No → Apply NZ IFRS 17

Fixed-fee service contracts that **could** be in scope of NZ IFRS 17:



Roadside assistance

Phone screen repair

Equipment breakdown

Upcoming amendments effective on or after 1 January 2024

Amendments effective for periods beginning on or after 1 January 2024

Standard	Amendment	Effective Date
NZ IAS 1 *Presentation of Financial Statements*	Classification of liabilities as Current or Non-Current and Non-current Liabilities with Covenants	1 January 2024
NZ IAS 7 *Cash Flow Statements* and NZ IFRS 7 *Financial Instruments: Disclosures*	Disclosures – Supplier Finance Arrangements	1 January 2024
NZ IFRS 16 *Leases*	Lease Liability in a Sale and Leaseback	1 January 2024
Financial Reporting Standard 44	Disclosure of Fees for Audit Firms' Services	1 January 2024*

*****Application is permitted for accounting periods that begin before 1 January 2024 but have not ended or do not end before 15 June 2023*

Amendments to NZ IAS 1 : Classification of liabilities as current or non-current

New basis of "current" liability classification

The amendments are effective for periods beginning on or after 1 January 2024, with earlier application permitted. Comparatives restated

Old requirement	No **unconditional** right	+	to defer settlement for at least 12 months after the reporting date
New requirement	No **substantive** right existing at reporting date	+	to defer settlement for at least 12 months after the reporting date

Management's intention or expectations does not impact classification

New Disclosure:

Disclose management's expectation to settle earlier than 12 months from reporting date

Covenant considerations for loan arrangements

Beginning of financial period
1 Jan 20x3

Reporting date
31 Dec 20x3

Covenants
conditions specified in a loan arrangement

Current Reporting Period

12-months After Reporting Period

Covenant

Considered for classification of liability for loan arrangement ***on or before*** reporting date

Future covenant

NOT considered for classification of liability for loan arrangement.

Disclosure requirements for non-current loan liability, risk that loan could be repayable 12-months after reporting date as entity may have difficulty complying with covenants.

NEW Disclosure Requirement

Future covenant

Not considered for classification of liability for loan arrangements.

No new disclosure requirements.

Settlement with shares – potential impact

Liabilities that can be settled with a company's own shares (e.g. convertible debt)

Generally, if a number of shares is a fixed number of shares known at inception, the conversion option is recognised as **equity** under NZ IAS 32.

Does not affect current or non-current classification of liabilities

Generally, if number of shares is not a fixed number known at inception, the conversion option is recognised as a **liability** under NZ IAS 32.

Affects current or non-current classification of liabilities

New

Application considerations

On-going international discussion
Classification MAY change

Straight-forward scenarios
Term loan with objective covenant, e.g. minimum debt/equity ratio
Term facility with rollover arrangement with objective covenant, e.g. minimum debt/equity ratio

Complex scenarios
Long term securitisation facility arrangement with rolling short-term receivables
Loan arrangement, including roll over facility with subjective covenant, for example: • material adverse change clause, • change ownership / control • delivery of unqualified financial statements
Hybrid instrument – discretionary interest, no fixed maturity, liability because redeemable if there is a change in control clause
Timing of substance assessment

Disclosure of fees for Audit Firms' Services

Tier 1

Disclose separately total fees incurred for services received from each audit or review firm and a general description of each service using the below categories:

- Audit or review of the financial statements
- Other audit or review services performed during the reporting period such as:
    - Audit or review related services
    - Other assurance services and other agreed upon procedures engagements
    - Taxation services
    - Other services

Tier 2

Reduced disclosure:

- Total fee incurred for services received from each audit or review of the financial statements
- Total fee incurred for any other services together with general description of those services

Application - periods beginning on or after 1 January 2024

IFRIC Agenda Decisions

The IFRIC agenda decisions

Likely frequency across entities:

High | Medium | Low

Agenda decisions finalised by IFRIC and IASB

- Guarantee over a derivative contract
- Homes and home loans provided to employee
- Insurance premiums receivable from an intermediary
- Definition of a lease – substitution rights

Tentative agenda decisions

- Payments contingent on continued employment during handover periods
- Merger between parents and subsidiary – separate financial statements

Remember:

- Accounting policy changes required if not consistent with agenda decision
- Keep up to date with our IFRS IC Agenda Decisions summary

Emission and green schemes

Environment conscious initiatives

Taxes, fees or charges

Compulsory payments to the government levied on certain tax base (for tax) or in proportion to the services provided (fees/charges)

Emission schemes

Allowance or permission to engage in an activity e.g. emit carbon. Can be issued under a trading system

Green projects

Investment in return for carbon credits generated by the project

Carbon offset schemes

Programmes used by individuals and businesses to neutralise their carbon emissions

Sustainable investing

Sustainable-linked financing: financing arrangements which reward borrowers who achieve their ESG targets with a lower cost of borrowing

Green bonds: Loans with specific purpose to fund projects that have positive environmental and/ or climate benefits

Environmentally motivated subsidies

Payment to discourage use of certain material/ product that has a proven negative impact on the environment

Emission schemes: Potential accounting considerations

Purpose and design of the scheme

- Mandatory or voluntary?
- Governing authority: government or industry bodies?
- How would an obligation be settled?
- Can the rights under the scheme be sold or traded? Is there an established trading platform?

Trader/ Investor
Polluter
Green Entity

Is there an asset?

- Business model of the entity
- How is the right acquired – self-generated, purchased, granted by government
- Unit of account
- Does right meet recognition criteria of relevant standard?

Is there a liability?

- What is the nature of any obligation – legal or constructive?
- What are the performance conditions to be fulfilled?
- When does the liability arise?

Polluter
Green Entity

Negative low emission vehicle credits

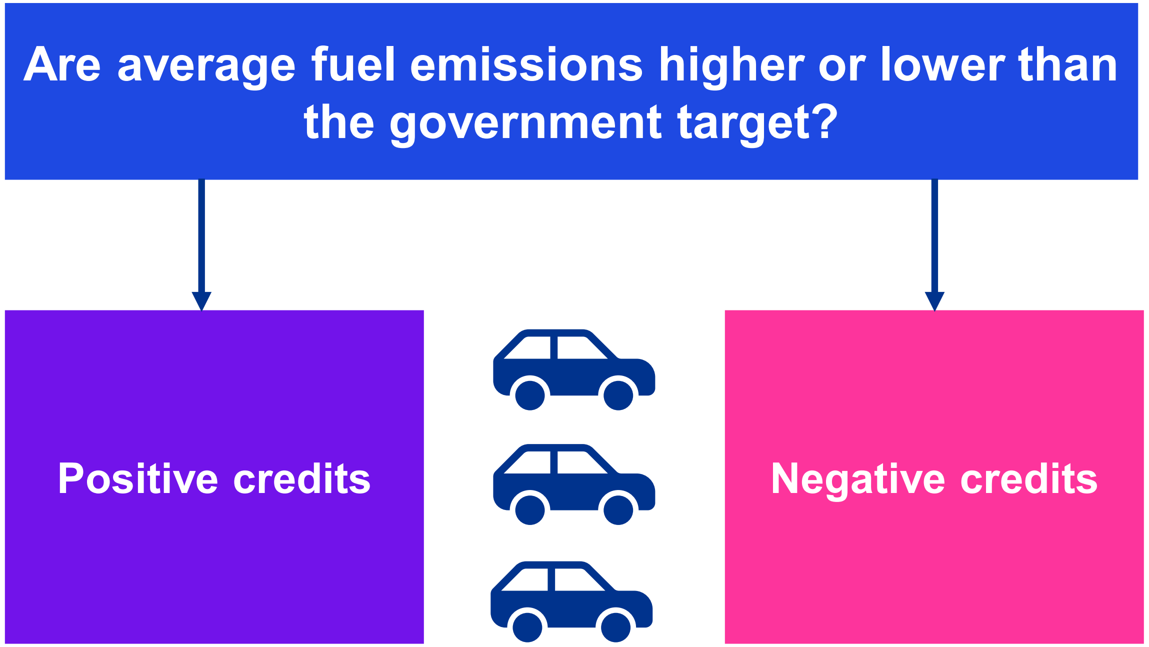
Is there a present obligation?

Under local law, an entity receives positive or negative credits depending on whether the average emissions of vehicle it produces or imports are higher or lower than the government target

An entity with **negative credits** at the end of the year must eliminate them by **obtaining and surrendering positive credits**. An entity can obtain positive credits by:

- **Purchasing** positive credits from another entity, or
- **Generating** positive credits in the future

If the entity fails to eliminate negative credits, the government can impose sanctions



Negative low emission vehicle credits

Liability

A **present obligation** arising from **past events**, the settlement of which is expected to result in an **outflow** from the entity of resources embodying **economic benefits**

Which event creates a present obligation?

Will settling an obligation to eliminate negative credits result in an outflow of resources embodying economic benefit?

Does the entity have a realistic alternative to settling the obligation?

Possibility of a constructive obligation?

Net zero and similar commitments

Which of these entities should recognise a provision for their net zero or similar commitments?

01

Freight Co. A plans to be net zero by 2050 and has committed to replace its current electric vehicles by 2030

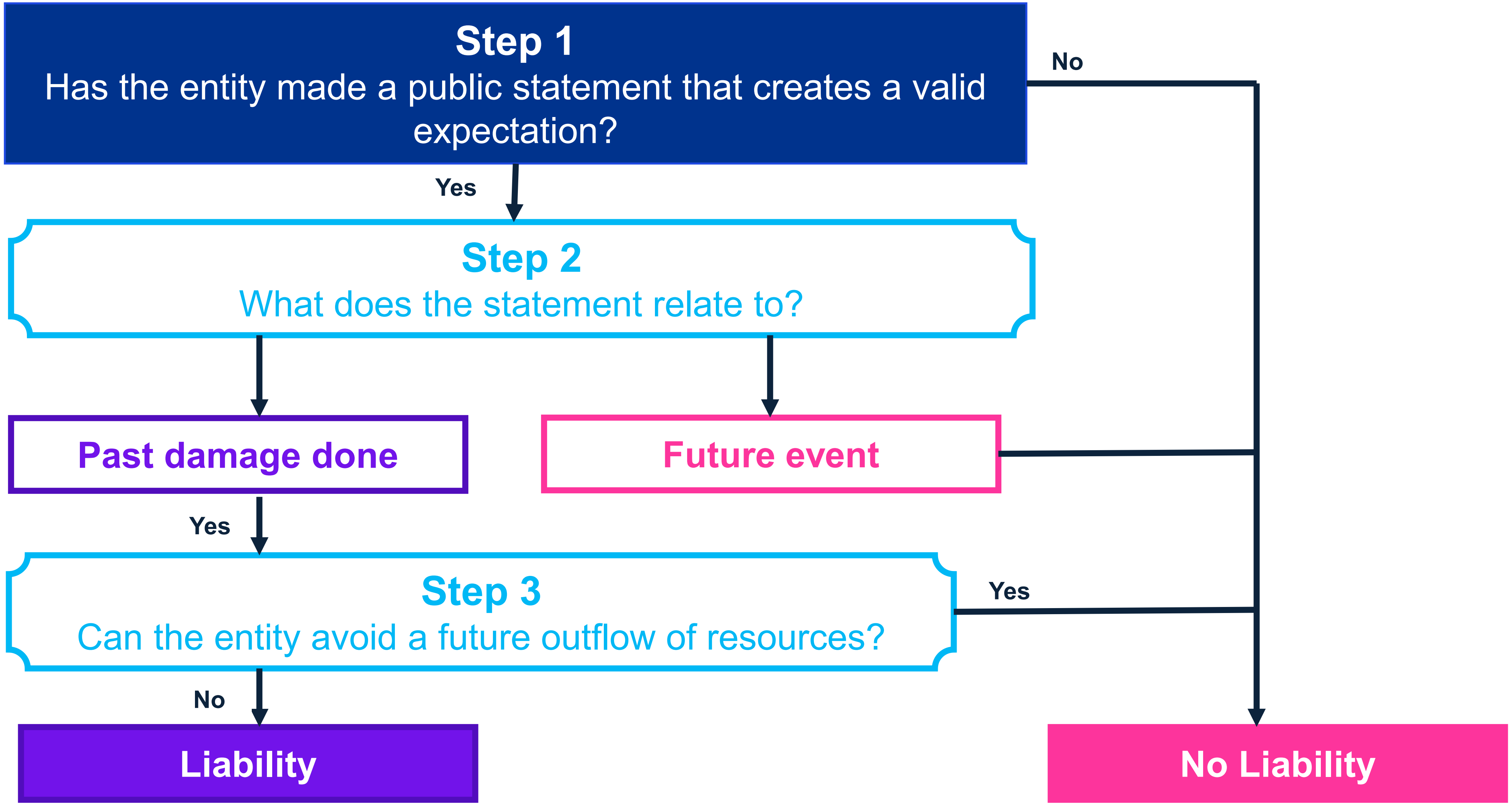
02

Airline B plans to be net zero by 2050 and has committed to increase its use of sustainable aviation fuel by 10% each year

03

Manufacturer C has committed to purchase sufficient carbon credits to ensure it is net zero in each annual reporting period

Net zero and similar commitments



Net zero and similar commitments

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03

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Purchasing carbon credits – the asset side

Consider the business purpose – i.e. whether of any of the following considerations apply

- Is the credit purchased together with other goods or services?
- Is the credit purchased with the intention of selling it in the ordinary course of business?
- Is the credit purchased to fulfil contracts with customers?
- Is the credit purchased for advertising or promotional activities?

Yes → **Business purpose drives the accounting**

No ↓

Carbon credit is typically held for use

↓

Should the entity recognise an asset?

Consider the nature of the economic benefits from the credit and when they are consumed

No → **Expense as incurred**

Yes ↓

How should it classify the asset?

Consider the specific facts and circumstances to determine whether intangible asset or inventory

Voluntary Emission schemes – generating carbon credits

Voluntary schemes are typically designed to create or generate carbon credits

Should carbon credits be recognised separately and at what amount?

How do we measure them after they are recognised?

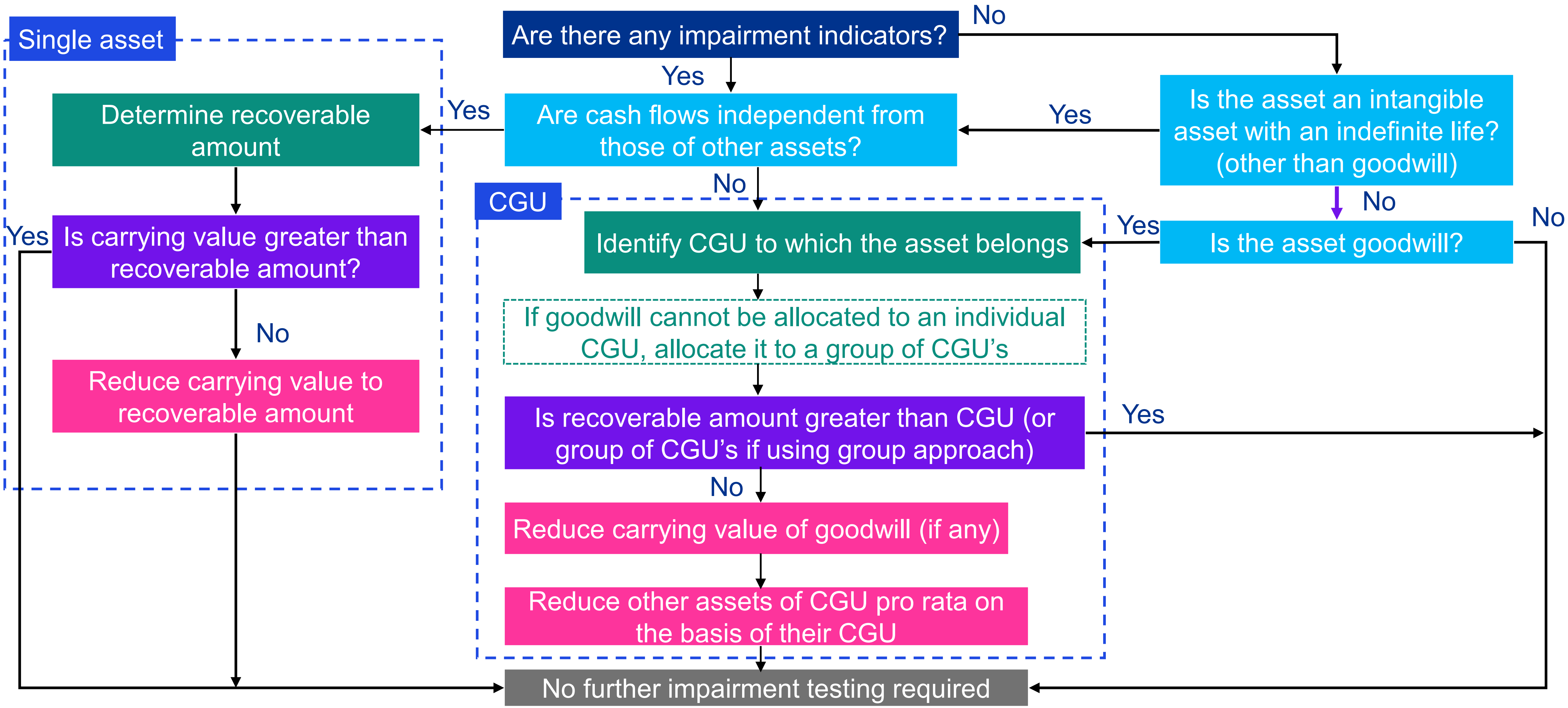
When are they derecognised?

Key takeaways

1. Understanding the terms of the scheme is critical
2. Determine how the entity is going to use the carbon credits as this will determine the impact on financial reporting
3. Understand what gives rise to an entity's obligations and when an obligation exists
4. Approach the analysis in a structured way

Impairment of non-financial assets

Reminder – NZ IAS 36 Impairment of Assets



Identification of Cash Generating Units (“CGUs”)

Levels of impairment testing

Determining the level where each asset is to be tested for impairment **does not default to the level of monitoring and decision making**

Entities often start and stop HERE!

Don’t forget the levels of testing

Be alert when testing goodwill at a ‘group of CGUs’ !

Level 3

Groups of CGUs

Level 2

Individual CGU

Individual CGU

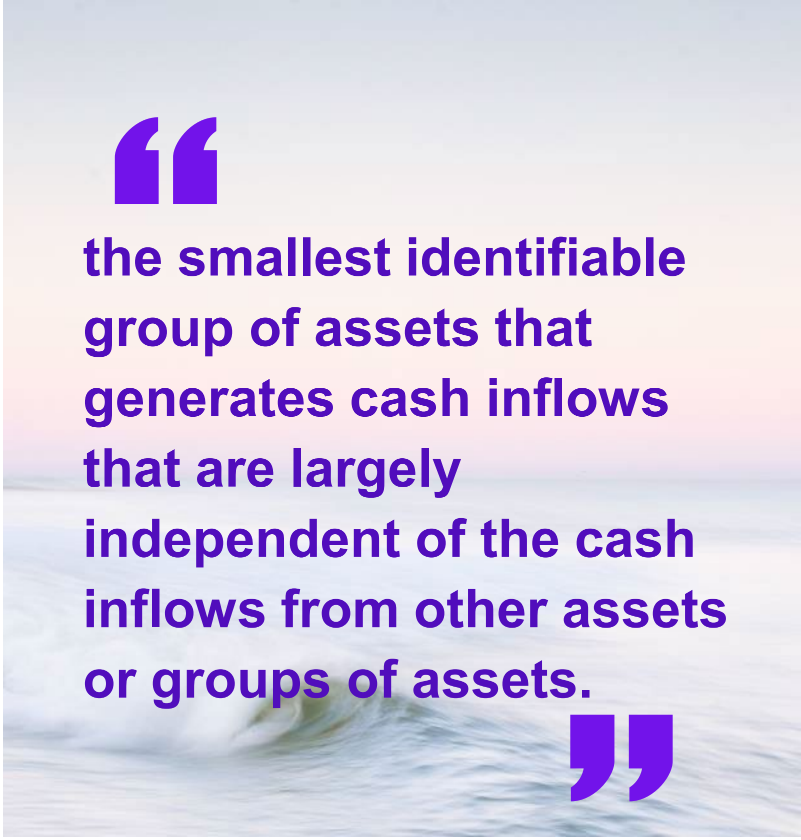
Level 1

Individual Asset

Individual Asset

Individual Asset

What is a CGU?



Can the individual asset generate largely independent cash flows inflows?
- Yes → Individual asset to be tested for impairment
- No → **Does a group of assets generate largely independent cash inflows?**
  - Yes → CGU to be tested for impairment
  - No → **Is there an active market for the output?**
    - Yes → CGU to be tested for impairment
    - No → Not a CGU (Continue to add assets or groups of assets and repeat assessment

Identifying cash generating units (CGUs)

Why is it important?

- CGUs define the level at which assets are to be assessed for impairment
- CGU's often initially identified at too high a level
- Identification of CGUs requires **judgement**

What is the risk?

CGU

Operation A: Headroom

Operation B: Impairment

CGU identified at **too high a level**, may mask impairment

CGU A

Operation A: Headroom

CGU B

Operation B: Impairment

CGU's are not expected to change unless business operations and the nature of goods and services change fundamentally.

Does a group of assets generate largely independent cash inflows?

Determining independent cash inflows:

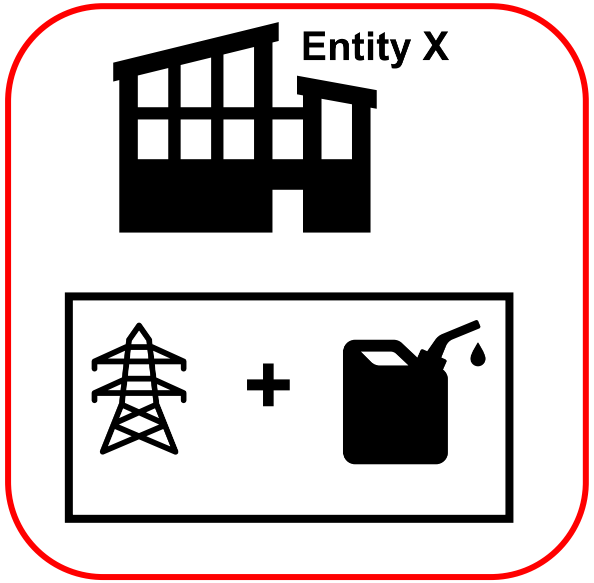
- Key test is identification of independent **cash inflows**
- Consider also
  - Manner in which management monitors operations, and
  - Makes decisions about continuing or disposing of assets and/or operations

Useful considerations:

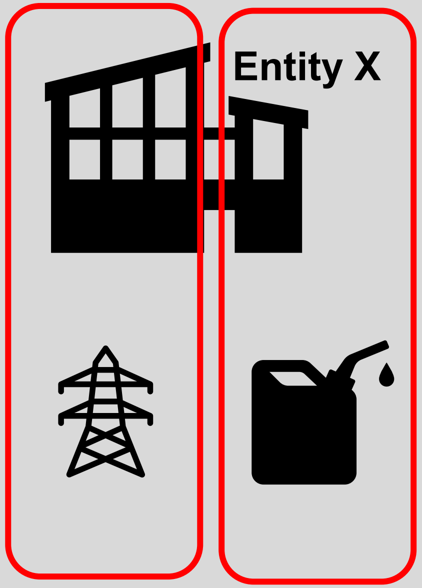
Revenue separation	Are the streams of revenue derived from these groups independent of one another?	• Sell bundled products or which have multiple revenue streams; • Have a large amount of referred work; or • Operate a large number of smaller outlets e.g. retail outlets
Asset separation	Are assets operated together to such an extent that they do not generate independent revenue streams? In making this assessment, the assets referred to are not corporate assets, rather, they are the core operating assets of the business	• Use a single asset base to generate different revenue streams; or • Use multiple assets on a portfolio basis to service or supply a customer or a small number of customers

Revenue Separation

Entity X is a utility company that caters to the residential customers in a particular region. It offers a ‘value-pack’ to its customers, which is a bundle of two products: electricity and a monthly gas refill at a 50% discount. Although customers can elect to buy the elements of the package separately, more than three quarters of customers choose the value-pack.

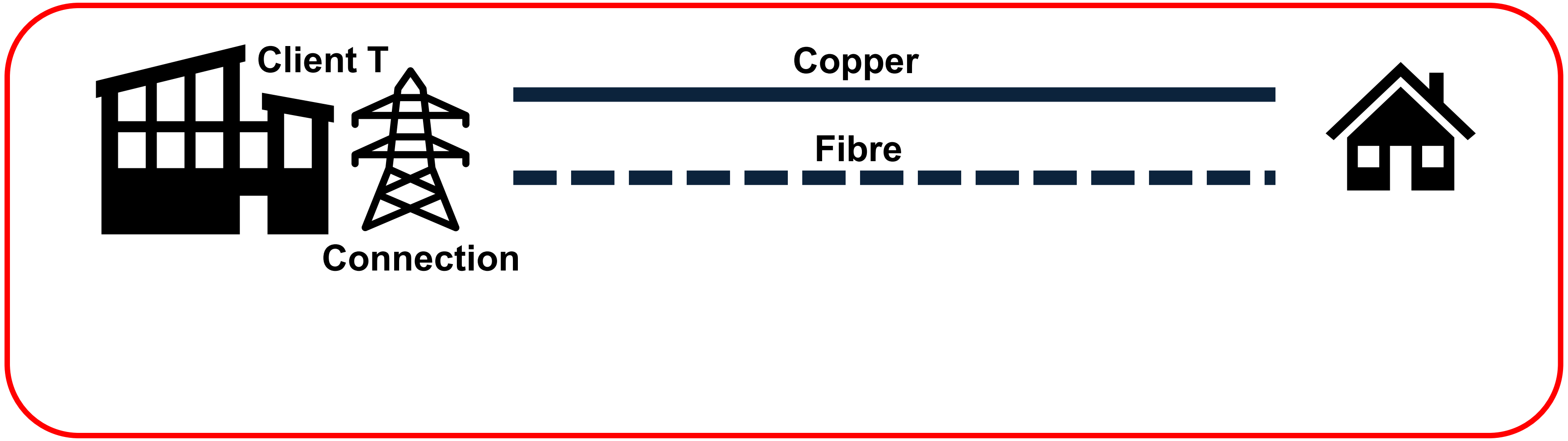


If we modify this example that less than half of its customers choose the value-pack



Asset Separation

Client T is a telecommunications company that offers fibre-to-the-premise services with the 'last mile' – i.e. the connection from the exchange or the cabinet to the customer's residence – being either copper or fibre. Both services are provided from a single fibre network, the backbone, which is the core operating asset.

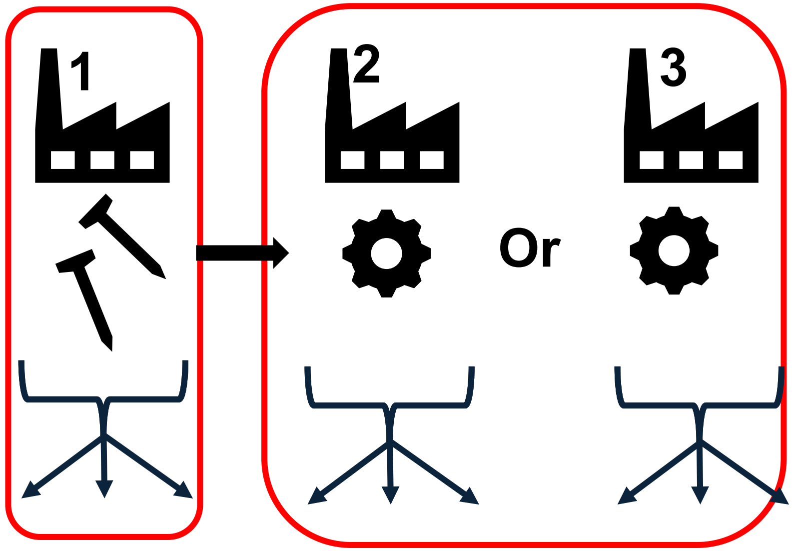


Is there an active market for the output?

Entity Y produces a single product (widgets) and owns production plants 1,2 and 3. Each plant is located in a different region of the world. Plant 1 produces a component of the widgets that is assembled in either plant 2 or plant 3 and sold worldwide from either plant 2 or plant 3. Neither plant 2 nor plant 3 is operating at full capacity.

The utilisation levels depends on the allocation of order fulfilment between the two locations.

There is an active market for plant 1's component



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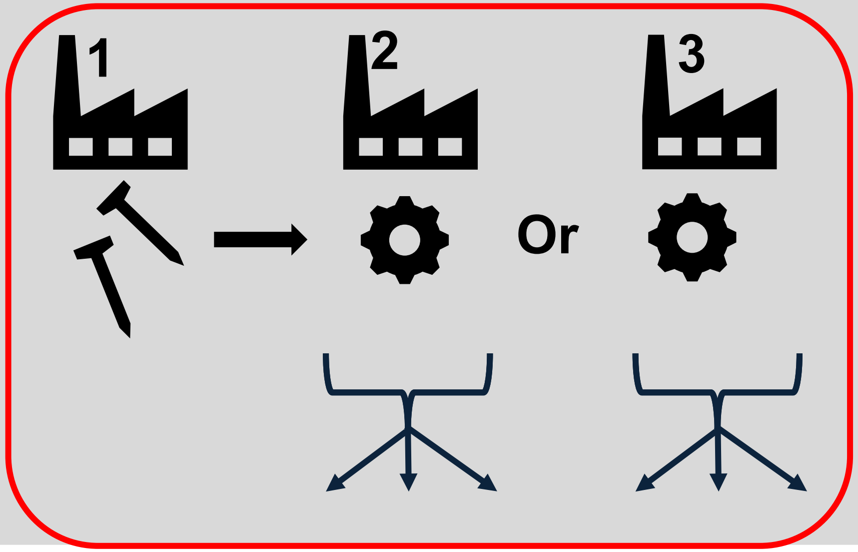

Impairment – practical issues

Practical issues for impairment testing

01 Scope of impairment testing

02 Identification of the recoverable amount

03 Determination of the value in use

04 Fair value measurement

05 Application of NZ IFRS 9 Financial Instruments

06 Reversal of impairment loss

Value in use (Discounted cash flow)

	Actual	Forecast →				
Year	**2023**	**2024**	**2025**	**2026**	**2027**	**Terminal**
EBITDA	1,218	1,279	1,304	1,331	1,357	1,378
Lease payments						(200)
Capital expenditure	(285)	(180)	(200)	(200)	(200)	(203)
Working capital movement	(28)	(12)	(18)	(23)	(26)	(26)
Tax on EBIT	(338)	(355)	(362)	(369)	(377)	(382)
Free cash flow (post tax)	567	732	725	738	755	566
Terminal value						6,580
Discount year		1.00	2.00	3.00	4.00	
Discount factor		0.92	0.85	0.78	0.72	0.72
Discounted cash flows		674	614	576	542	4,730
NPV =Recoverable amount	**7,137**					
CGU carrying amount	**6,700**					
Headroom	**437**					

	Carrying amount
Goodwill	300
Fixed assets	5,200
Right of use asset	1,200
Lease liability	-
Total CGU	**6,700**

Assumptions

Post tax WACC	8.6%
Terminal growth rate	1.5%
Tax rate	28%

1. Key issues?
2. Common mistakes?

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3

Assumptions

Post tax WACC	8.6%	5
Terminal growth rate	1.5%	6
Tax rate	28%	

Common errors in value in use impairment test

	Common errors	Key Reminder
1	EBITDA	Cross-checking these assumptions to possible external evidence would support the reasonableness of the discount rate and the cash flows used in determining value in use.
2	Inconsistency of working capital treatment	Cash flow forecasts should be based on the latest management-approved budgets or forecasts. It should be consistent with the assets being tested in the carrying amount.
3	Leases	If it is a post-IFRS 16 test, a key assumption is whether a potential buyer of a CGU will assume the lease liability on disposal or not.
4	Headroom	If the recoverable amount just happen to be slightly over the carrying amount, the DCF could be adapted in some way just get them over the line.
5	Post-tax discount rate disclosed in financial statement.	In practice, post-tax discount rate is used along with post-tax cash flows. However, for disclosure purposes, the pre-tax discount rate should be disclosed.
6	Real vs Nominal cash flows	Nominal cash flows are most commonly used in cash flow forecasts and these include effects of general inflation/CPI. However, not all costs experience the same exposure to inflation.

Other common errors

Common errors	Key Reminder
Assumptions	The cashflows and assumptions should be reasonable and supportable. For example, If market capitalisation is lower than a VIU calculation, the appropriateness of the assumptions should be challenged.
Formula errors	Formulas should be checked as part of the review process.
Foreign currency	When an asset or CGU generates cash flows in a foreign currency, those cash flows should first be estimated in the currency in which they will be generated. These cash flows should be discounted using a discount rate appropriate for that currency.
Tax expenses/losses	If tax cash outflows are calculated by multiplying EBIT by the statutory tax rate and discounted using a post tax discount rate, then the carrying value of any recognised deferred tax assets/deferred tax liability should be excluded from the total carrying value of the CGU used in impairment testing.

KPMG

Thank you

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