Converting to international accounting standards

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Over the past two years the Financial Reporting Standards Board (FRSB) and Accounting Standards Review Board (ASRB) have had their noses to the grindstone, preparing what is effectively a new set of generally accepted accounting principles (GAAP) based on International Financial Reporting Standards (IFRS).

They had two main aims: providing an approved set of standards that allowed for profit entities to simultaneously be able to claim compliance with IFRS and New Zealand GAAP, and maintaining standards that are relevant to public benefit entities.

In pursuing this aim, they sought to comply with the parameters laid down by the ASRB for the process which are as follows:

- The IFRS disclosure requirements cannot be reduced for profit-oriented entities.
- Additional disclosure requirements can be added for all entities.
- Recognition and measurement requirements in an IFRS cannot be amended for profit-oriented entities.
- Recognition and measurement requirements can be amended for public benefit entities, with a rebuttable presumption that amendments are based on existing International Public Sector Accounting Standards (IPSAS) or existing FRS, as applicable.
- Guidance materials may be added based on the same principles as applying to addition of recognition and measurement requirements (as outlined above).
- Where an IFRS contains alternative permissible treatments the ASRB may determine that only one option can be applied to be able to comply with NZ GAAP. Where an IFRS permits options that are not allowed in existing FRS, a strong argument will need to be made for the board to agree to such options in the New Zealand equivalents to IFRS. In reaching a view on this issue the board will be mindful of the approach adopted by the Australian Accounting Standards Board (AASB).

Now that this exercise is complete, it is appropriate to review what has been done. There are a number of benefits to be gained by this.

- The work represents, in effect, an in-depth analysis of the IASB stable platform by a country willing and wishing to adopt IFRS, and lessons from that exercise should be worth communicating to the IASB.
- The work forced the New Zealand standard setters to confront the issue of sector neutrality and challenge the paradigm that one set of standards is appropriate for both sectors – there are lessons from this in terms of issues that we should raise with the IASB and International Public Sector Accounting Standards Board (IPSASB), and lessons we can take ourselves as we continue to seek to provide accounting standards that are relevant to the public benefit sector.
- The ASRB parameters were agreed after a significant period of debate at the start of the exercise; they represented more of a compromise position than a set of principles and at no point in the process was there a feeling that they had been fully signed up to as a permanent and enduring basis for New Zealand standard setting in the future. How well have they worked in practice? What have we learned from applying those rules to the stable platform that we should take into the future?

An analysis of the additional material (or New Zealand paragraphs) added to IFRS reveals some interesting observations. Ignoring the oft-repeated definition of public benefit entities, the New Zealand standard setters have made, by my count, some 135 "all entities" additions and some 63 "public benefit entities" (PBEs) additions to the international accounting standards. Twice as many changes were made for reasons other than public sector coverage than because of it! However a large number of "all entity" additions were in fact in industry specific standards, namely banks, financial institutions, retirement plans, and insurers, so perhaps the comparison isn't quite fair.

The table on the next page illustrates the main changes made[1], classified according to the ASRB criteria.

So what are the lessons from the conversion process?

The international context

New Zealand is one of the first countries with a significant set of national accounting

ASRB criteria	Actual changes
IFRS disclosure requirements cannot be reduced for profit-oriented entities	• No reductions for profit-oriented entities • PBEs that revalue are not required to disclose historical cost information (NZ IAS 16, 77.1, NZ IAS 38,124.1) • PBEs not required to disclose related party transactions caused by common Crown ownership (NZ IAS 24, 17.1-4)
Additional disclosure requirements can be added for all entities	• Comparative prospective information (NZ IAS 1, 41.1) • Non-audit fees (NZ IAS 1, 92.1) • Inventories held for distribution (NZ IAS 2, 36.1) • Reconciliation of operating cash flows (NZ IAS 7, 20.1-2) • Cash flows reported net and why (NZ IAS 7, 24.1) • Restricted cash (PBEs only) (NZ IAS 7,49.1) • Changes in accounting policies (NZ IAS 8, 31.1) • Imputation and withholding payment credits (NZ IAS 12, 81.1) • Details of valuers used (NZ IAS 16, 77.2-3, NZ IAS 40, 75.1) • Government grants if reported net (NZ IAS 20, 39.1) • Actuarial information on retirement plans (NZ IAS 26) • Specified items for retirement plans (NZ IAS 26) • Aggregated disclosures of associates (NZ IAS 28, 37.1) • Line item and note disclosures by banks (NZ IAS 30) • Line item disclosures in interim reports (NZ IAS 34, 10.1) • Comparative balance sheets in interims (NZ IAS 34, 20.1)
Recognition and measurement requirements in an IFRS cannot be amended for profit-oriented entities	• No amendments, although a clarification made on calculating the defined benefit provision (NZ IAS 19, 55.1-2)
Recognition and measurement requirements can be amended for public benefit entities, with a rebuttable presumption that amendments are based on existing IPSAS or existing FRS, as applicable	• Inventories held for distribution (NZ IAS 2, 9.1-3, 34.1) • Donated assets, affecting inventory, property, plant and equipment, intangibles and investment property (Various) • Segment reporting (NZ IAS 14, 4.1) • Class of assets revaluations (NZ IAS 16, 39-40) • Government grants (NZ IAS 20, 1.1) • Three month allowance for subsidiaries (NZ IAS 27, 27.1) • Impairment of non-cash generating assets (NZ IAS 36, 2.1) • Social policy obligations (NZ IAS 37, 3.1-3)
Guidance materials may be added based on the same principles as applying to addition of recognition and measurement requirements	• Definition of materiality (NZ IAS 1,11.2) • Definition of going concern (NZ IAS 1, 24.1-2) • Examples of inventories (NZ IAS 2, 8.1-2) • Guidance on output expense presentation (NZ IAS 1, 92.1) • Examples of operating cash flows (NZ IAS 7, 14.1) • Guidance on distributions to owners (NZ IAS 10, 12.1) • Impact of restructures on going concern (NZ IAS 10, 15.1) • Property, plant and equipment examples (NZ IAS 16, 5.1) • Depreciated replacement cost (NZ IAS 16, 33.1-14) • Asset management plans and LRARA (NZ IAS 16, 61) • Guidance on control (NZ IAS 27,12.1) • Examples of investment property (NZ IAS 40, 9.1)
Where an IFRS contains alternative permissible treatments the board may determine that only one option can be applied to be able to comply with NZ GAAP.	• Direct cash flow presentation of cash flow statements option required (NZ IAS 7, 18-20) • Investment property required to be valued on the fair value model and movements in fair value taken through the profit and loss (NZ IAS 40, 30-32)

standards to convert to international accounting standards. NZ IFRS effectively became regulation in December 2004. The Australian equivalents to IFRS were "made" in July 2004. Despite the recognition that in undertaking this conversion, it may be necessary to "step backwards to go forwards", when it came to the crunch, standard setters, myself included, were reluctant to let go of requirements, particularly disclosure requirements, that were considered valuable in the New Zealand context. Some reasons for this are discussed below.

Some detailed disclosure requirements in standards support open, transparent and light-handed regulatory regimes, which are a feature of the New Zealand environment – for example reporting by superannuation funds and financial institutions.

Some disclosures represent good corporate governance practice that is well entrenched in New Zealand, which there was a reluctance to signal any distancing from, e g disclosure of audit fees, comparative prospective information, details of valuers and interim disclosures.

The option in the international accounting standard to allow an indirect cash flow presentation was seen as an unnecessary step backwards, given that the cash flow to financial performance reconciliation provides all the information provided by the indirect cash flow presentation, that empirical studies have proven the value of the direct cash flow method and the fact that it is now well established in New Zealand. With respect to investment property, the IASB has not made this mandatory as property markets may not be well established. While this may be true globally, it does not apply in New Zealand.

Having gone through the conversion exercise and utilised the ability to make additional disclosures or limit options from the international standards, the onus is now on standard setters to develop generally agreed principles for making future amendments to increase disclosures or reduce options or adapting such amendments as issues resurface on the IASB's agenda.

On the one hand, financial reporting for New Zealand entities should not be more onerous than for others competing in the global capital markets. On the other hand, national standard setters can be expected to consider the extent that the particular nature of New Zealand's business and regulatory environment should impact on particular reporting requirements in a manner not possible or appropriate in an international context. Achieving an appropriate balance will be difficult.

It is notable that Australia, the country with perhaps the most similar regulatory environment to New Zealand, has made a number of similar amendments to those made in New Zealand to increase disclosures or reduce options. The blending of reporting requirements applicable generally with reporting requirements specific to a particular regulatory regime could be an issue for the international standard setters (both the IASB and IPSASB) to consider, as well as national standard setters adopting international accounting standards.

Sector neutrality

The adoption of NZ IFRS with public benefit entity amendments has allowed a "sector-inclusive" set of standards to be developed. NZ IFRS retains its relevance to the public and not-for-profit sectors. If accounting is said to be the language of business, public and private sectors are still speaking the same language, albeit with different accents emerging.

While a full sector-neutral process where standards are developed from the start with both sectors in mind is no longer possible, the requirement of both the FRSB and ASRB to continue to consider the IASB-produced standards from a public benefit entity perspective has meant that New Zealand retains its niche skill and capability that justifies our status as one of the IASB's eight standard setter partners.

My personal analysis of the conversion process outcome would be to categorise the 10 (only 10!) PBE recognition, measurement or disclosure changes made in New Zealand into four categories:

- items which, if the international accounting standards were followed, would represent an inappropriate loss of accountability to stakeholders e g government grants, disclosures on the restriction of the use of cash
- items that the IASB has simply not dealt with or has only dealt with in a perfunctory manner e g inventories that an entity intends to distribute at no charge, donated assets, impairment of non-cash generating assets, social policy obligations
- items that would be inappropriate in New Zealand because of other regulatory requirements e g service performance reporting requirements obviating the need for segment reporting, financial year definitions in statute overriding the international standards conventions regarding subsidiaries' harmonisation of reporting dates with parents
- items that could be unduly onerous for PBEs and which would not otherwise benefit stakeholders e g related party transactions conducted at arm's length between government entities, individual asset revaluations, the requirement to disclose the historical cost of revalued assets.

What should be clear from the above analysis is that compliance with NZ IFRS by PBEs does not represent a lower standard of accounting than NZ IFRS compliance by profit-oriented entities. Rather, the PBE insertions have led to more appropriate, more relevant requirements on PBEs.

Looking forward, the issues noted above are obvious candidates for New Zealand to discuss with the IASB. Some of the issues may be eliminated in the future. The current IASB projects on government grants and on reporting financial performance represent excellent opportunities to converge. However, it is likely that other issues will take their place. For example, the International Financial Reporting Interpretations Committee (IFRIC) has recently proposed accounting guidance for public-private-partnerships that scope out the accounting by the public sector entity – a prime candidate for adding to the list of items that the IASB has not dealt with that New Zealand standard setters will need to consider.

Guidance

The other category identified in the table at the start of this article is the addition of guidance material. In this respect it is notable that international accounting standards are now adopting a different structure than the one we have been used to in New Zealand. Accompanying each new standard is a basis for conclusions, and usually interpretation guidance and application guidance. To the extent that New Zealand standards have provided such material in the past, it has often been within the body of the standard itself.

The FRSB has already signalled its intention to develop PBE guidance and it is likely that much of the NZ material, retained from previous standards, that now appears in NZ IFRS will be repositioned to application guidance. The question the FRSB has to resolve is the extent it is prepared to "make pronouncements", in the manner envisaged in IAS 8, that have applicability to entities other than PBEs. For example, it is possible to envisage application guidance in New Zealand for accounting by trusts, by farmers and by cooperatives.

While such pronouncements could be expected to be rare, as any significant issue should be addressed through the international accounting standard setting framework, and any non-significant issue is unlikely to be worth the effort, it is notable that other standard setters adopting IFRS have not resiled from making such pronouncements.

Conclusion

As we emerge from the frenzy of the conversion process, the challenges for New Zealand accounting standard setters after establishing NZ IFRS are becoming clearer. They are:

- determining the principles to guide New Zealand insertions to increase disclosures or reduce options from emerging international accounting standards
- encouraging the IASB to ensure that differences do not unnecessarily emerge between accounting in the private and public sectors
- providing guidance where differences do emerge
- developing application guidance for the public benefit entities (and perhaps beyond).

Footnote

1. Note that this is a summary of the major amendments, and should not be treated as a complete listing. ■