

Country Practice – New Zealand

The Move to International Accounting Standards in New Zealand

By Michael Bradbury (*Massey University*) and Tony van Zijl (*Victoria University of Wellington*)

On the 19 December 2002, the Accounting Standards Review Board (ASRB) announced that New Zealand reporting entities should apply International Financial Reporting Standards (IFRS) for periods on or after 1 January 2007. However, entities would have the option to early adopt IFRS from 1 January 2005. For a small country like New Zealand there are significant benefits to be gained from adopting, or at least adapting, overseas standards. It provides a set of comprehensive, credible and internationally recognized standards at relatively low cost. Application of these standards in financial reporting by New Zealand entities reduces transaction costs for international investors contemplating investment in New Zealand and thus facilitates deepening of local capital markets.

In this newsletter we discuss the move to IFRS in New Zealand. We first, briefly, review prior attempts at harmonization or convergence with overseas accounting standards. Second we discuss the likely impact on IFRS. Third, we discuss the possible challenges that lay ahead.

Prior attempts at international convergence

The first attempt to provide accounting guidance in New Zealand was made by the profession in 1946 when it reproduced for use by New Zealand entities the recommendations on accounting principles issued by the Institute of Chartered Accountants of England and Wales (Zeff 1973 and van Zijl 1994). The New Zealand profession began to issue accounting standards in 1974 and in the same year became an associate member of the International Accounting Standards Committee (IASC). An early standard carried the IASC crest but thereafter, the profession pursued its own agenda and wholesale adoption of international standards was regarded as inappropriate because of legal, commercial and professional differences (Bradbury 1998).

The Financial Reporting Act of 1993 established the Accounting Standards Review Board (ASRB) to provide legal backing to accounting standards developed by the profession's Financial Reporting Standards Board (FRSB). In June 1994, the ASRB issued a statement of the intention to harmonize Australian and New Zealand accounting standards (i.e., eliminate unnecessary differences) .

The ASRB's decision to adopt IFRS in New Zealand was prompted by the Australian Financial Reporting Council's directive to adopt IFRS in Australia in 2005, but this was only a factor in the timing of the decision. Consultations made by the ASRB showed strong support for the adoption of IFRS by New Zealand entities. For some parties the support reflected the interest in adopting internationally recognized standards, for others it simply reflected there was no effective option other than to follow Australia (Bradbury and van Zijl 2006).

The impact of IFRS

IFRS are developed for large consolidated listed firms. However, NZ accounting standards are described as "sector-neutral" and apply to a wide range of entities and across all sectors. In addition to stock exchange listed firms and other entities that issue securities to the public, NZ accounting standards apply (1) to small closely held companies (this has led NZ to develop a differential reporting regime to lower the cost of financial reporting for small entities) and (2) to public benefit entities. Public benefit entities are reporting entities whose risk capital (if any) has been provided to support the primary objective of providing goods or services for a community or a social benefit rather than for financial return to equity holders. Most state sector entities, local authorities, and not-for-profit entities are public benefit entities.

ASRB *Release 8*, describes the procedures required to be followed by the FRSB in adopting IFRS to replace New Zealand Financial Reporting Standards. The FRSB has developed New

(continued on page 10)

Country Practice—New Zealand *(continued from page 9)*

Zealand equivalents to IFRS (“NZ IFRS”) for approval by the ASRB. The new standards use the same identification as IFRS, preceded by “NZ”. For example, the New Zealand equivalents to IAS 11 and IFRS 3 are NZ IAS 11 and NZ IFRS 3.

ASRB *Release 8*, allows NZ IFRS to differ from IFRS under limited circumstances. NZ IFRS may contain additional disclosure items; eliminate optional treatments allowed under IFRS; and may contain additional recognition and measurement requirements for public benefit entities. The additional requirements are included in shaded boxed text. This approach allows profit-oriented entities to comply with NZ IFRS and claim compliance with IFRS. However, it does mean that while there is one set of accounting standards, New Zealand no longer has sector-neutral standards, because public benefit entities, in complying with the additional requirements for those entities in NZ IFRS, may not be able to claim compliance with IFRS.

The impact of the adoption of IFRS on financial statements in New Zealand varies across entities depending on the type of transactions they undertake, the operating structure and financial structure. As New Zealand had no standards on accounting for employee benefits, share-based payments, or recognition and measurement of financial instruments, the adoption of IFRS has had a major impact on reporting in these areas. Other standards having a significant impact are deferred tax, goodwill impairment, and fair value for agriculture activities (for details of specific effects see Bradbury and van Zijl 2005 and 2007).

The challenges ahead

Major issues arising from the scope of IFRS in New Zealand remain unresolved. These relate to the attempts to retain *differential reporting* for smaller entities and *sector neutral* accounting for public benefit entities.

Pre-IFRS New Zealand had a differential reporting regime that provided relief from full-GAAP for certain smaller entities. The *Framework for Differential Reporting* granted full, partial or no exemptions from financial reporting standards. Although one set of standards was used, specific exemptions were recorded in each standard. As an interim measure, the exemptions in individual standards in pre-IFRS standards were “rolled-over” into NZ IFRS. However, New Zealand must now decide whether to :

- continue with the existing differential reporting, or
- replace the existing scheme with the eventual output of the IASB’s *Small and Medium-sized Entities* project requiring having GAAP in two books; or
- develop its own “two book” approach.

Choice among these alternatives is complicated by the fact that the Ministry of Economic Development is currently considering changing the requirements on which entities must file financial statements (and therefore, effectively, comply with GAAP).

The second major scope issue, is whether New Zealand can continue to provide one set of accounting standards for both profit-oriented and public benefit entities. The New Zealand Controller and Auditor-General has questioned whether NZ IFRS meets public sector needs. Of particular concern, is that the joint FASB/IASB conceptual framework project will consider the impact of public benefit entities late (the second to last phase) in the project. Also, this project has subsumed the role of stewardship within a decision usefulness objective. The lack of focus on accountability in the proposed conceptual framework will make the task of operating with a single set of sector neutral standards increasingly difficult.

(continued on page 11)

Country Practice—New Zealand *(continued from page 10)*

A further issue is that once full convergence with IFRS has been achieved there will need to be reconsideration of the role of the FRSB and ASRB. With the adoption of IFRS, the FRSB's role as a standard setter is substantially eliminated. The FRSB's function is more likely to be that of an advocate for New Zealand entities by responding to and submitting to the IASB on discussion papers and exposure drafts.

The move to IFRS is a major step in the evolution of financial reporting. It brings new challenges for preparers, auditors, users of financial statements, standard setters and educators.

References

- Bradbury, M.E., 1998, Harmonisation with Overseas Standards: A New Zealand Perspective" *Australian Accounting Review* 8: 18-23.
- Bradbury, M.E. and T. van Zijl, 2007, International Financial Reporting Standards and New Zealand – Loss of Sector Neutrality, *Research in Accounting Regulation*, 19: 37-54.
- Bradbury, M.E. and T. van Zijl, 2006, Due Process and the Adoption of IFRS in New Zealand" *Australian Accounting Review* 816(2): 86-94
- Bradbury, M.E. and T. van Zijl, 2005, Shifting to IFRS, *University of Auckland Business Review*: 77-83.
- van Zijl, T. 1994, Financial Reporting Regulation, in G. Walker and B. Fisse (eds), *Securities Regulation Australia and New Zealand*, Oxford University Press, Auckland: 420-443.
- Zeff, S., 1979, *Forging Accounting Principles in New Zealand*, Victoria University Press, Wellington.

Country Practice—Australia

Adoption of International Accounting Standards in Australia from 2005

By Ann Tarca (University of Western Australia), 9 April 2008

Australia has a relatively long history of support for the harmonisation of Australian accounting standards with international accounting standards (IAS and IFRS) issued by the International Accounting Standards Board (IASB). In the 1990s the national standard setter (the Australian Accounting Standards Board or AASB) had a convergence policy and it also reviewed all Australian standards to ensure that compliance with them achieved compliance with IAS. Adoption of IAS/IFRS was initially proposed for 1 January 1999, but subsequently delayed until 1 January 2005 (FRC, 2002a, 2002b). This article provides an overview of issues arising from adoption of IAS/IFRS in Australia under four headings, being comparability, support of constituents, financial effect and impact on the standard setting process.

Comparability

The aim of adoption of IAS/IFRS in Australia was to improve the international comparability of Australian companies' financial reporting. While many Australian constituents considered that Australian GAAP was of a high quality, there was debate about its ability to be recognised internationally. The motivations for adoption of IAS/IFRS in Australia were similar to those experienced in Europe. That is, companies sought greater international transparency and comparability in their financial reporting, which was expected to lead to cheaper cost of capital. In addition, adoption was seen by the Australian Securities Exchange (ASX) as promoting further development of the national capital market.

(continued on page 12)

Country Practice—Australia *(continued from page 11)*

Unlike the situation in the European Union (EU) (where IAS/IFRS are used by only listed companies in their consolidated accounts) IAS/IFRS are adopted by all reporting entities (all listed companies plus other entities for which there are users reliant on the general purpose financial reports) in Australia. This means that a large range of companies have been affected by adoption, including smaller companies.

Like New Zealand, Australia has ‘sector neutral’ accounting standards. The effect of this approach to standard setting has seen the AASB add material to IASB standards (which are developed solely for private sector entities) to make them applicable for not-for-profit and public sector entities. These days changes are made to standards only to achieve sector neutrality. However, such changes mean that the standards are not literally ‘as issued by the IASB’ which may have implications for companies seeking to have their accounts accepted in international capital markets (such as the USA).

Constituent support

International standards (IAS/IFRS) had widespread support from many parties in the business community (Brown and Tarca, 2001), particularly prior to Australia’s formal adoption decision in 2002. Arguments for adoption seemed compelling: greater international comparability for Australian companies and reduced costs of developing accounting standards. Jones and Higgins (2006) surveyed preparers prior to adoption about expected benefits. When asked whether the economic benefits listed below were likely to be achieved, participants responded as follows:

Increased access to overseas capital markets -	57% disagree
Reduced cost of capital -	75% disagree
One set of reports (cross-listing) -	75% disagree
More transparent/understandable standards -	60% disagree
Lower quality of financial reports -	67% disagree

The survey suggests that support for adoption was not unanimous. A subsequent post adoption survey by Pickering et al. (2008) pointed to the frustration experienced by preparers with the time taken over conversion and its cost. Some preparers expected little benefit from adoption and sought more assistance with interpretation of the new standards. These studies highlight the impact of a government policy decision which focused on the benefits to a few, namely large listed companies with international operations and the ASX itself. Indeed, the Federal Government was not without self interest in the adoption process, as adoption was a way of removing standard setting from the domestic political agenda.

Financial effect

At the time of adoption, the major differences between IAS/IFRS and AGAAP were in the areas of Financial instruments, Intangibles, Income tax, Business combinations, Goodwill, Impairment and Share-based payment (Jones and Higgins, 2006). However, the financial effect of adoption varied greatly based on company size and industry. An early study (based on the first half-year financial statements of the earliest adopting firms) showed that more than half small firms had no change in net income or equity. IAS/IFRS increased net income for small and medium sized firms and increased equity for small firms. Under the new standards, small firms experienced higher earnings variability than medium or large firms (Goodwin and Ahmed, 2006).

Impact on standard setting

Adoption of IAS/IFRS created major changes in the standard setting structure in Australia. The AASB is no longer responsible for developing accounting standards

(continued on page 13)

Country Practice—Australia *(continued from page 12)*

from their inception which significantly diminishes the scope of its activity and its power in standard setting (Collett et al., 2001; Brown and Tarca, 2001). Clearly, the AASB has lost autonomy over the standards it releases which subsequently become Australian law.

The AASB can make changes to IFRS before issuing AASB equivalents to IFRS, however, in practical terms, it is limited in the extent to which it can do so. The AASB is unlikely to take actions inconsistent with the harmonisation of standards, given its directions from its oversight body, the Financial Reporting Council, and community support for harmonisation. For example, the AASB is unlikely to follow the precedent set by the EU in making a ‘carve out’ before endorsing IAS 39.

Currently the AASB contributes to international standard setting through its relationship with the IASB. Standish (2003) argues that the ability of a country to be influential at the IASB reflects such factors as 1) existence of a national standard setting process; 2) ability to address complex accounting issues in the English language; 3) involvement in the standard setting community; and 4) development of the knowledge base (through the academic community and accounting and auditing professions). Considering all of these factors, Australia is well placed to be able to participate in global standard setting in the future. For example, the AASB has been a national liaison standard setter since the formation of the IASB in 2001 and has participated in several IASB projects where it has particular expertise (eg intangible assets and extractive industries).

The Australian corporate sector has been influential in standard setting in the past, however adoption of IAS/IFRS will curtail this influence. Companies can lobby the IASB in much the same way as they lobbied the AASB but they cannot expect to be as influential, given that the IASB is an international organisation concerned with the views of many stakeholders from various countries. Loss of influence in standard setting by Australian companies can be observed in relation to IAS 38 *Intangibles*. Australian companies with substantial revalued or internally generated intangible assets lobbied the IASB, the AASB and the Federal Government for relief from IAS 38 requirements, based on the impact that they would have on companies’ financial statements (Ravlic, 2004; Walters, 2004). Companies’ requests were unsuccessful and some adjustments occurred to financial statements, although it seems that these were fewer than initially predicted (Cheung et al., 2008). On this issue at least, the AASB has been unable to negotiate with the IASB to achieve an outcome that was considered important by some Australian companies. The result illustrates the loss of power of the AASB and companies in the (now international) standard setting process.

Australian companies have a history of lobbying the Federal Government in relation to accounting standards. The development of standards by the IASB, and the adoption by the AASB of those standards, further distances the Government from the standard setting process. The Government can argue that the rules are determined in an international arena for the global capital market and, unless not in Australia’s best interest, they will be adopted in Australia. The post-2005 standard setting arrangements mean that the Government lacks the incentive to intervene in standard setting. Therefore, the Government can expect less lobbying directed to it over any future controversial standards, which it may view as a favourable outcome of IFRS adoption.

Conclusion

Fundamental changes in accounting standard setting in Australia have occurred following the FRC’s decision in 2002 that Australia would adopt international accounting standards. The decision marks the end of an eventful era of domestic standard setting. Standard setting will occur in an international arena in the future. It will continue to be a political process, however, political activity will operate increasingly at an international level, with the ability of the AASB, the Australian corporate community and even the Australian government to influence the process being significantly less than it has been in the past.

The aim of convergence of accounting standards is to achieve one set of global accounting standards, thus improving comparability and transparency in financial reporting and reducing companies’ cost of capital and financial report preparation costs. To achieve these benefits, participants in

(continued on page 14)

Country Practice—Australia *(continued from page 13)*

the Australian environment have incurred the significant transition costs. In addition, they have accepted less influence and autonomy in standard setting in the future. Benefits of adoption are not apparent for all firms, particularly smaller companies without international connections. Recent events in the USA (including the removal of the SEC's Form 20-F US GAAP reconciliation requirement and consideration of IAS/IFRS for use by domestic companies) indicate greater acceptance of IAS/IFRS on an international scale. The IAS/IFRS adoption decision was probably inevitable for Australia and is based on the belief that benefits will be realised for listed firms and the Australian market overall.

References

- Brown, P. and A. Tarca (2001) 'Politics, processes and the future of Australian accounting standards', *Abacus*, 37(3): 267-296.
- Collett, P., J. Godfrey, and S. Hrasky, (2001) 'International harmonisation: Cautions from the Australian experience', *Accounting Horizons*, 15(2): 171-182.
- Cheung, E., E. Evans and S. Wright (2008) 'The adoption of IFRS in Australia: The case of AASB 138 (IAS 38) Intangible Assets' *Australian Accounting Review*, September 2008 (forthcoming).
- Financial Reporting Council (FRC)(2002a) *Bulletin of the Financial Reporting Council 2002/4*, 3 July. Available from <http://www.frc.gov.au/content/bulletins.asp>.
- Financial Reporting Council (FRC)(2002b) *Bulletin of the Financial Reporting Council 2002/5*, 18 December. Available from <http://www.frc.gov.au/content/bulletins.asp>.
- Goodwin, J. and K. Ahmed (2006) 'The impact of International Financial Reporting Standards: Does size matter?' *Managerial Auditing Journal* 21(5):460-475
- Jones, S. and A. Higgins (2006) 'Australia's switch to International Financial Reporting Standards: A perspective from account preparers', *Accounting and Finance* 46: 629-652
- Pickering, J., S. Aisbett, S. Gray and R. Morris (2008) 'Preparers' perceptions of the costs and benefits of IFRS adoption in Australia: "Regulation gone mad"?' Working Paper, University of Sydney.
- Standish, P. (2003) 'Evaluating national capacity for direct participation in international Accounting harmonisation: France as a test case', *Abacus*, 39(2): 186-210.
- Ravlic, T. (2004) 'CCA's \$1.9-billion teaser', *CFO*, 1 September: 82.
- Walters, K. (2004) 'Standards fightback', *Business Review Weekly*, 12 February: 36.
-