

RELEASE 9

ISSUED SEPTEMBER 2007

## **Delay of the Mandatory Adoption of New Zealand Equivalents to International Financial Reporting Standards for Certain Small Entities**

*Issued by the Accounting Standards Review Board*

### **INTRODUCTION**

1. In December 2002, the Accounting Standards Review Board (the Board) announced that it had decided that New Zealand entities would be required to apply International Financial Reporting Standards (IFRSs), issued by the International Accounting Standards Board (IASB), for periods commencing on or after 1 January 2007. Early adoption is permitted for periods commencing on or after 1 January 2005. Many countries around the world, including Australia and the European Union, have also adopted IFRSs or are in the process of doing so.
2. Since that announcement, the Board has reviewed and approved the New Zealand equivalents to IFRSs (NZ IFRSs), developed by the Financial Reporting Standards Board (FRSB) of the New Zealand Institute of Chartered Accountants, in accordance with procedures outlined in ASRB Release 8 *The Role of the Accounting Standards Review Board and the Nature of Approved Financial Reporting Standards*.
3. To date in New Zealand, NZ IFRSs have largely been adopted by large issuers, subsidiaries of overseas companies complying with IFRSs and the public sector. Generally, small entities have yet to begin the process of adopting NZ IFRSs. In the meantime, the applicability of IFRSs to small entities has been the subject of significant debate: internationally, with the IASB's publication of an Exposure Draft of a Proposed IFRS for Small and Medium-sized Entities; in Australia, with revisions to the financial reporting regime for small proprietary companies; and in New Zealand, with the extensive consultation meetings recently conducted by the FRSB on financial reporting by small and medium-sized entities.
4. In addition, in September 2007, the Minister of Commerce advised the ASRB and FRSB that a government review of the financial reporting requirements applying to small and medium-sized companies under the Financial Reporting Act 1993 will commence in mid-2008.
5. As a consequence, the Board has decided that the mandatory adoption of NZ IFRSs should be delayed for certain small entities that meet specified criteria. The purpose of the Release is to announce the Board's decision and to further explain the reasons for that decision.

## **REVIEW OF THE REPORTING REQUIREMENTS FOR SMALL AND MEDIUM-SIZED COMPANIES**

6. The Financial Reporting Act 1993 (the Act) requires companies, other than exempt companies, to prepare financial statements that comply with generally accepted accounting practice (GAAP). To comply with GAAP, as defined by the Act, those financial statements must comply with applicable financial reporting standards.
7. As noted in paragraph 4 above, the Minister of Commerce has advised the ASRB and FRSB that a review of the financial reporting requirements applying to small and medium-sized companies under the Act will be commencing in mid-2008.
8. One issue that this review may well consider is whether New Zealand should adopt a similar financial reporting regime as currently exists in Australia for small and medium-sized companies. Under the Australian Corporations Act 2001, small proprietary companies are not required to prepare financial statements, unless directed to do so.<sup>1</sup> Recently, the size thresholds to qualify as a small proprietary company were substantially increased.<sup>2</sup>
9. One possible outcome of the review could be that many small and medium-sized companies would no longer have a legislative requirement to prepare GAAP-compliant financial statements. This possibility calls into question whether these companies should be required to adopt NZ IFRSs now. Of particular concern are those companies that currently prepare GAAP-compliant financial statements solely because of the legislative requirement to do so. If that requirement were to be removed in a few years' time, the costs of changing from existing financial reporting standards to NZ IFRSs now are likely to outweigh the benefits.
10. Therefore, the Board decided that the mandatory adoption of NZ IFRSs should be delayed for certain small companies that meet specified criteria.

### **ASRB DECISION**

11. The Board has decided that companies, which satisfy *all* of the following criteria, are permitted to continue to apply the existing approved New Zealand Financial Reporting Standards (FRSs) and, therefore, are not required to apply NZ IFRSs for periods beginning on or after 1 January 2007, until further notice:

---

<sup>1</sup> Such a company may be directed to prepare financial statements by shareholders with at least five percent of the votes (under section 293 of the Corporations Act 2001) or by the Australian Securities and Investments Commission (under section 294).

<sup>2</sup> A proprietary company is a small proprietary company for a financial year if it satisfies at least two of the following thresholds:

- the consolidated gross operating revenue for the financial year of the company and the entities it controls (if any) is less than A\$25 million;
- the value of the consolidated gross assets at the end of the financial year of the company and the entities it controls (if any) is less than A\$12.5 million;
- the company and the entities it controls (if any) have fewer than 50 employees at the end of the financial year.

- (a) The company is not an issuer, as defined by the Act, in either the current or preceding accounting period;
  - (b) The company is not required by section 19 of the Act to file its financial statements with the Registrar of Companies<sup>3</sup>; and
  - (c) The company is not large, as defined by section 19A<sup>4</sup> of the Act.
12. Companies that are required to prepare financial statements in accordance with GAAP and that meet the above criteria will continue to have a choice between two sets of standards, the existing FRSs or NZ IFRSs.

### **ANNOUNCEMENT OF APPLICATION DATE OF NZ IFRSs**

13. When the government review is completed, it will be established which, if any, of the companies affected by the above decision will continue to have a legislative requirement to prepare financial statements that comply with GAAP. At that time, the Board intends to determine the date upon which any such companies will be required to adopt NZ IFRSs. Furthermore, the Board intends that there will be a minimum of one year between the date of the announcement of that decision and the earliest mandatory date of transition to NZ IFRSs.
14. However, the Board's intentions set out in paragraph 13 are subject to the government review being completed within a reasonable period of time. The existing Financial Reporting Standards are not being maintained and, therefore, there may become a point when continuing to apply those standards is no longer appropriate.

### **EFFECT ON OTHER TYPES OF ENTITIES**

15. The Board is responsible for reviewing and, if it thinks fit, approving financial reporting standards submitted to it for application to the financial statements of entities subject to the Act. These entities include issuers, companies, local authorities, crown entities, state sector bodies and any other entity that is required by another enactment to comply with the Act as if it were a reporting entity. For entities subject to the Act, the delay of the mandatory adoption of NZ IFRSs applies only to companies that meet the criteria in paragraph 11. Hence, all entities subject to the Act, other than exempt companies and companies that meet the criteria in paragraph 11, will be required to adopt NZ IFRSs for periods beginning on or after 1 January 2007.
16. In addition to entities subject to the Act, there also are many other types of entities that are not subject to the Act. Examples include sole traders,

---

<sup>3</sup> In general, section 19 of the Act requires a company to file its financial statements if it is:

- an overseas company or a subsidiary of an overseas company; or
- large and 25% of its voting power is held by overseas shareholders (entities or individuals).

<sup>4</sup> A company is defined as large if it meets any two of the following three size thresholds:

- as at balance date, the total assets (including intangible assets) of the company and its subsidiaries (if any) exceeds \$10 million;
- the total turnover of the company and its subsidiaries (if any) exceeds \$20 million;
- as at balance date, the company and its subsidiaries (if any) have 50 or more full-time equivalent employees.

partnerships, trusts, charities, clubs, societies and associations. Some of these other types of entities may be required to (e.g. by requirements established in their founding documents or in contractual arrangements with third parties), or choose to, prepare general purpose financial statements in accordance with GAAP.

17. Although the Board has no statutory mandate over these entities, the Board is conscious that its decisions affect these entities, through its role in approving financial reporting standards. The Board is aware also that the Ministry of Economic Development (MED) is considering the financial reporting regime for charities. It is not yet known what the outcome of this work will be, nor when any legislative change in the financial reporting requirements for charities would come into effect. However, one possible outcome of this work is that, as with companies, some small charities that currently prepare GAAP-compliant financial statements may no longer need to do so in a few years' time. If that were to occur, it calls into question the benefits of adopting NZ IFRSs now. Therefore, the Board supports the proposals of the FRSB to extend the delay of the mandatory adoption of NZ IFRSs to other small entities, as explained below.
18. The *New Zealand Preface*, issued by the FRSB, explains the meaning of GAAP for entities that are not subject to the Act and that prepare general purpose financial statements. The Board understands that, as a consequence of the Board's decision to delay the mandatory adoption of NZ IFRSs for some companies, the FRSB has decided that the mandatory adoption of NZ IFRSs also will be delayed for some other entities that are not subject to the Act and that prepare general purpose financial statements. Specifically, the FRSB has decided that this delay will apply to entities that are not publicly accountable and are not large, as defined in the *Framework for Differential Reporting*. The Board understands that the *New Zealand Preface* will be amended to reflect the decisions of the Board and the FRSB.

*Warwick E. Hunt*

Chairman

Accounting Standards Review Board

September 2007