

# Accounting Alert

A Focus On Topical Financial Reporting and Accounting Issues  
14 November 2003 / Issue 16

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## For more information visit:

- *IASplus.com* - a Deloitte website detailing up to the minute IFRS developments as well as reporting on the current and proposed output of the IASB.
- *Deloitte.co.nz* for New Zealand based publications including this *Accounting Alert*.

## Recent Exposure Drafts

The phenomenal pace of change continues! The following exposure drafts have been issued by the Financial Reporting Standards Board (FRSB) as part of the process to converge with International Financial Reporting Standards (IFRS).

### **ED NZ IAS-1: Presentation of Financial Statements, and ED NZ Interpretation SIC-29: Disclosure Service Concession Arrangements**

#### **New Zealand Standards Affected**

FRS-2: *Presentation of Financial Reports* and FRS-9: *Information to be Disclosed in Financial Statements*. In addition some areas cover what is currently included in SSAP-6: *Materiality in Financial Statements*, and FRS-27: *Right of Set-off*.

#### **Major Changes to Existing Practice**

- Disclosure of extraordinary items is prohibited – items are shown separately in the Statement of Financial Performance.
- All entities must state compliance with NZ IFRS and/or IFRS.
- Presentation of minority interests must be separately disclosed on the Statement of Financial Position and on the face of the Statement of Financial Performance as a deduction from profit or loss.
- Some movements in equity can be disclosed in the notes instead of on the face of the financial statements.
- Some items must now be disclosed as current liabilities regardless of management intent e.g. a long-term financial liability due to be settled within 12 months of balance date must be classified as a current liability regardless of whether agreements to refinance are deemed likely, or even completed after balance date but before the financial statements are authorised. Similarly where debt falls due as a result of breaches of covenants and this has not been rectified at balance date, the debt must be classified as current even if the financier waives the breach or the agreement is renegotiated after balance date but before the financial statements are authorised.
- New requirement to disclose assumptions about the future where there is measurement uncertainty and significant risk of material adjustment to the carrying amounts of assets and liabilities within the next financial year.
- New requirement to disclose judgements made by management in applying the accounting policies which have the most significant effect on amounts in the financial statements.
- Under ED NZ interpretation SIC-29 there will be more disclosure of service concession arrangements.



More disclosure may be required for public benefit entities.

Leases involving both land and buildings will need to be classified as two separate elements under ED NZ IAS-17.

## **ED NZ IAS-14: Segment Reporting**

### **New Zealand Standard Affected**

SSAP-23: *Financial Reporting for Segments*

### **Major Changes to Existing Practice**

- SSAP-23 applies to the audited financial statements of all entities other than wholly owned subsidiaries of entities reporting in New Zealand and those qualifying for differential reporting. ED NZ IAS-14 applies to all profit oriented entities whose debt or equity securities are publicly traded and to entities in the process of issuing equity or debt securities in public securities markets. As a result certain profit-oriented entities that have not issued equity or debt securities will no longer be required to provide segment information (e.g. profit oriented entities owned by public benefit entities).
- SSAP-23 also applies to all public benefit entities which prepare general purpose financial statements. This may lead to more disclosure for some public benefit entities.
- The segment types for public benefit entities will change from a business segment (industry) and a geographical segment as defined in SSAP-23, to a service segment and geographical segment. As a result public benefit entities will need to review the segments they report for consistency with the new segment definitions.
- Detailed guidance is included in ED NZ IAS-14 on the identification of segments which may result in differences to current disclosures, particularly for public benefit entities. This may result in more reportable segments and increased disclosures – for example non cash expenses, depreciation and amortisation expense for each segment, cost to acquire segment assets and the share of net profit or loss of investments accounted for under the equity method.

## **ED NZ IAS-17: Leases, NZ Interpretation SIC-15: Operating Leases - Incentives, and NZ Interpretation SIC-27: Evaluating the Substance of Transactions in the Legal Form of a Lease**

### **New Zealand Standard Affected**

SSAP-18: *Accounting for Leases and Hire Purchase Contracts*

ED NZ IAS-17 is based on the International Accounting Standards Board's (IASB) improvements exposure draft for IAS-17. The IASB is currently considering comments on the revisions made to IAS-17 in the improvements project. As a result this standard may be subject to further amendments.

### **Major Changes to Existing Practice**

- Leases involving both land and buildings will need to be classified as separate elements. While the land component is generally classified as an operating lease, the buildings element is classified as either an operating or finance lease. For example the building component of property leases under long term or infinite operating leases will be classified as finance leases even though title is not transferred. This may lead to a change in classification.
- SSAP-18 permits the recognition of finance income based on a pattern reflecting a constant periodic rate of return on either the lessor's net investment outstanding or the net cash investment outstanding in respect of the finance lease. Recognition based on the net cash investment outstanding will no longer be permitted under ED NZ IAS-17.
- ED NZ IAS-17 requires a number of additional disclosures not specified in SSAP-18 for both lessees and lessors.



*Further changes are expected to several of these standards.*

## **ED NZ IAS-23: Borrowing Costs**

### **New Zealand Standards Affected**

FRS-3: *Property, Plant and Equipment* and FRS-4: *Inventories*.

### **Major Changes to Existing Practice**

No significant change.

## **ED NZ IAS-33: Earnings per Share**

### **New Zealand Standard Affected**

There is no current NZ standard. Listed companies on the New Zealand Stock Exchange are required to comply with IAS-33.

ED NZ IAS-33 is based on the IASB's improvements exposure draft for IAS-33. The IASB is currently considering the comments received on the revisions made to IAS-33 in the improvements project. As a result this standard may be subject to further amendments.

### **Major Changes to Existing Practice**

This standard applies to entities whose ordinary shares or potential ordinary shares are publicly traded, and by entities in the process of issuing shares in public securities markets. It also applies to all entities that disclose earnings per share. Previously in New Zealand, this standard only applied to companies listed on the New Zealand Stock Exchange.

The improvements project proposed the following key changes to IAS-33:

- Contracts that can be settled in cash or shares at the issuer's option should be included as potential ordinary shares in the calculation of diluted earnings per share.
- Clarification of the types of transactions that should lead to adjustments in calculating basic earnings per share - for example transactions involving an entity's preferred shares.
- Additional guidance and examples on complex matters - for example potential ordinary shares of subsidiaries, joint ventures and in relation to participating securities.

## **ED NZ IAS-37: Provisions, Contingent Liabilities and Contingent Assets**

### **New Zealand Standard Affected**

FRS-15: *Provisions, Contingent Liabilities and Contingent Assets*

### **Major Changes to Existing Practice**

- The ED only allows the recognition of contingent assets where inflow is virtually certain, with disclosure required for those assets which are probable. FRS-15 requires disclosure unless the probability of inflows are remote. As a result fewer contingent assets are likely to be disclosed.
- The ED requires separate disclosure of any reimbursement where it is virtually certain (FRS-15 - probable) that the reimbursement will be received. While FRS-15 requires the expense relating to a provision to be recognised separately, the ED permits it to be presented net of the amount recognised as a reimbursement.

Some further revisions to IAS-37 are expected later this year.



*Investment properties are measured at fair value with changes in fair value taken to net profit or loss.*

## **ED NZ IAS-40: Investment Property**

### **New Zealand Standards Affected**

SSAP-17: *Accounting for Investment Properties and Properties Intended for Sale*, and FRS-3: *Accounting for Property, Plant and Equipment*.

Note: Properties held for sale are covered by IASB ED-4.

### **Major Changes to Existing Practice**

- Investment properties are measured at fair value. Fair value does not include disposal costs unlike SSAP-17's requirement to recognise at net current value. IAS-40 gives the option to use cost measurement subsequent to initial recognition. This option is proposed to be removed in the New Zealand standard.
- Changes in fair value are taken to net profit or loss – not to a revaluation reserve.
- SSAP-17 allows the recognition in income (on a percentage of completion basis) of the development margin on investment properties in certain circumstances. The change in value of development properties classified as investment properties will fall under ED NZ IAS-16: *Property, Plant and Equipment* which requires revaluation changes to be taken to a revaluation reserve.
- SSAP-17 states that a property is an investment property if the owner or the group does not occupy more than 20%. ED NZ IAS-40 does not specify a percentage - but requires that the "own use" portion is insignificant. Some classification may change if portions of property could be sold separately (or leased out separately under a finance lease) as the portions are accounted for separately.
- ED NZ IAS-40 states that when a property is leased to, and occupied by, its parent or another subsidiary, the lessor treats the property as investment property in its individual financial statements, despite the property being owner-occupied from the perspective of the group.

## **IFRIC Draft Interpretation D2: Changes in Decommissioning, Restoration and Similar Liabilities**

### **New Zealand Standards Affected**

This draft interpretation, "D2", provides guidance on accounting for changes in the measurement of decommissioning, restoration and similar liabilities accounted for as a provision under IAS-37: *Provisions, Contingent Liabilities and Contingent Assets*, and capitalised under IAS-16: *Property, Plant and Equipment*. The requirements of IAS-37 and IAS-16 are comparable to those in the current New Zealand FRS-15: *Provisions, Contingent Liabilities and Contingent Assets* and FRS-3: *Accounting for Property, Plant and Equipment*.

### **Major Changes to Existing Practice**

The Interpretation provides guidance in relation to changes that arise from the revision of estimated outflows of resources embodying economic benefits, and revisions to the current market-assessed discount rate. D2 proposes that these changes are accounted for in the same manner as the initial estimated cost. Therefore, amounts relating to the depreciation of the asset that would have been recognised to date are reflected in current period income or expense and amounts relating to future depreciation are capitalised.

D2 proposes retrospective application for first time adopters of IFRS. The liability should be measured using the current discount rate and the asset should be remeasured as if this rate had applied on initial recognition and the asset had subsequently been depreciated. There would not be a requirement to restate for each discount rate change arising in prior years.



*The implementation of a New Zealand converged IAS-39 is expected to have significant implications for reporting entities.*

## Update on Financial Instruments

There is only limited guidance on financial instruments in New Zealand. FRS-31: *Disclosure of Information about Financial Instruments*, is similar to IAS-32: *Financial Instruments: Disclosure and Presentation*, however there is no financial reporting standard comparable to IAS-39: *Financial Instruments: Recognition and Measurement*. Therefore the implementation of a New Zealand converged IAS-39 is likely to have significant implications for reporting entities.

In June 2002 the IASB issued an exposure draft of proposed improvements to IAS-32 and IAS-39, and in August 2003 a further exposure draft amendment to IAS-39 was issued entitled *Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk*. The proposed amendment allows fair value hedge accounting to be used for a portfolio hedge of interest rate risk (macro hedging). It is expected that ED NZ IAS-32 and IAS-39 will be issued in late 2003/early 2004, subsequent to their issue as standards by the IASB.

Reporting entities will need to be familiar with the requirements of IAS-32 and IAS-39. The standards and accompanying guidance run to several hundreds of pages so early familiarity is encouraged.

### IAS-39 at a Glance

- All derivative financial instruments (including embedded derivatives) are required to be recognised at fair value. All changes in the fair value of derivatives, other than those instruments meeting certain hedge criteria, are recognised in the net profit or loss for the period.
- There are prescriptive rules on documentation, designation and effectiveness testing to determine whether an item can be treated as a hedge for accounting purposes, and the standard outlines how to account for hedges.
- Hedges cannot be designated retrospectively so entities will need to make sure they meet the requirements at the beginning of the reporting period (and the comparative period for other than 2005 adopters).
- Measurement of a financial asset depends on its classification. Certain categories of financial assets meeting very strict criteria may be carried at amortised cost. The rest must be recorded at fair value.

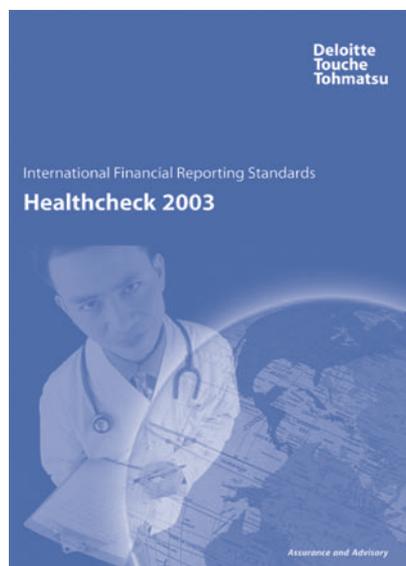
## Deloitte Publications

### International Financial Reporting Standards Healthcheck 2003

The adoption of IFRS promises to be a major business issue for all New Zealand reporting entities. The ramifications of adoption expand further than a change in accounting numbers with potential impacts on debt covenants, systems enhancements, bonus arrangements and compensation plans, management reporting, taxation planning, investor relations and treasury management.

The IFRS Healthcheck 2003 can be used to assist you in determining whether your organisation is on track to achieve a smooth transition to IFRS.

You can download this and other Deloitte IFRS related publications as they become available from [www.deloitte.co.nz](http://www.deloitte.co.nz)





## Corporate Governance Developments

**A**s a result of Enron and other high profile corporate failures and accounting scandals policymakers around the world have moved to put in place more stringent corporate governance requirements - the most notable of these are the US requirements arising out of the Sarbanes-Oxley Act 2002.

Recent developments in New Zealand include:

- On 29 October the New Zealand Stock Exchange (NZX) Corporate Governance Listing Rules came into effect. The new rules include a requirement for the identification of independent directors, a requirement for an audit committee, and a requirement for Issuers to disclose any corporate governance practices which materially differ to those in the Corporate Governance Best Practice Code. Visit [www.nzx.com](http://www.nzx.com) for more information.
- In September the Securities Commission issued a background paper and questionnaire asking for feedback in their development of an agreed set of Corporate Governance principles to reflect the unique nature of New Zealand business. A copy of the questionnaire and background paper are available at: <http://www.sec-com.govt.nz/publications/documents/corporate-governance/index.shtml>

### Important Dates

The FRSB's timetable is aligned to that of the IASB. As the IASB issues standards, the FRSB will issue them as NZ IAS or NZ IFRS having made additions, where necessary, to ensure the standards are sector neutral. As a result the NZ agenda is subject to change as deliberations of the IASB proceed.

An up to date timetable is available at [www.iasplus.com/agenda/timetabl.htm](http://www.iasplus.com/agenda/timetabl.htm)

Keep track of these important dates for responding on Exposure Drafts to the FRSB:

#### Comment Due 30 November 2003:

- ED NZ IAS-33: *Earnings Per Share*

#### Comment Due 15 December 2003:

- ED NZ IAS-17: *Leases*, NZ Interpretation SIC-15: *Operating Leases - Incentives*, and NZ Interpretation SIC-27: *Evaluating the Substance of Transactions in the Legal Form of a Lease*
- ED NZ IAS-40: *Investment Property*

#### Comment Due 31 January 2004:

- ED NZ IFRS-1: *First-time Adoption of International Financial Reporting Standards* (refer to Issue 15 of our Accounting Alert for a summary of IFRS-1. ED NZ IFRS-1 is based on this international standard with no significant changes).
- ED NZ IAS-14: *Segment Reporting*
- ED FRS-34A: *Life Insurance Activities*
- ED FRS-35A: *Financial Reporting of Insurance Activities*

An article on changes in financial reporting for insurance contracts will shortly be available at [www.deloitte.co.nz](http://www.deloitte.co.nz)

All exposure drafts are available through the Institute's website: [www.icanz.co.nz](http://www.icanz.co.nz)

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