RESERVE
BANK
OF NEW ZEALAND

Banking System Department

12 August 2002

Ms Lay Wee Ng
Director – Accounting and Professional Standards
Institute of Chartered Accountants of New Zealand
PO Box 11-342
WELLINGTON

Dear Ms Ng

IMPROVEMENTS TO INTERNATIONAL ACCOUNTING STANDARDS

Attached are our comments on the proposed improvements to international accounting standards.

Our interest in these improvements mainly relates to issues that could potentially affect the accounting for the financial statements of financial institutions. As our comments are restricted to the proposed improvements, we also reserve our judgement on the substance of any of the International Accounting Standards that may relate to the improvements.

We hope that our comments assist.

Yours sincerely

Peter Ledingham
Head of Financial System Oversight

Ref #123208

2 The Terrace, PO Box 2498, Wellington, New Zealand

APPENDIX

IAS 1 Presentation of Financial Statements

Question 1

The Bank considers that the most defendable approach is the New Zealand one whereby reporting entities are required to comply with GAAP, and if in doing so a true and fair view is not given, then additional information should be disclosed which presents that view.

We also observe that many national accounting standard setters are likely to issue (potentially modified) IAS's in their own name rather than the IASB's, in which case the rules pertaining to individual national financial reporting frameworks will be most relevant.

In this context, a more practical approach is probably not to include these requirements in an IAS, and leave the issue of compliance with GAAP to each of the national legal or regulatory authorities who deal with these issues.

IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

The Bank supports the proposed changes made to IAS 8.

IAS 21 The Effects of Changes in Foreign Exchange Rates

Question 2

In making decisions about the presentation currency, each entity or branch operation within a group should take into account factors such as:

> GAAP within the country in which it operates;
>
> the need to ensure the comparability of financial statements within the financial reporting context in which it operates;
>
> the main audience to whom the financial statements are targeted.

Normally these factors will result in the presentation currency corresponding with the national currency of the country in which the entity or branch conducts its business. But generally this should not cause conflicts with the provisions of IAS 21, because most often the functional currency for such operations is also likely to correspond with the national currency.

With respect to multinational corporations, we also note that it is probably not very practical for them to prepare financial statements in several currencies, one each for all the countries in which they operate. In these circumstances, the financial statements and group financial statements of the entity heading the multinational are probably best presented on the basis of the functional currency in which the global operations are primarily conducted.

Our understanding here is that the functional currency is defined to include currencies which are linked to the currency of the primary economic environment in which an entity operates.

IAS 24 Related Party Disclosures

Question 2

As does the Board, the Bank does not agree with the IASB proposal not to require separate disclosure of related party transactions and outstanding balances in the separate financial statements of a parent or wholly-owned subsidiary that are that are made available or published with the consolidated financial statements for the group to which the entity belongs.

We consider that the related party disclosures on the reporting entity as a legal entity are as important, and in some respects more important, than those pertaining to the consolidated financial statements.

IAS 27 Consolidated and Separate Financial Statements

Question 1

We would like to point that the revised paragraph 8 conflicts with the provisions of the Financial Reporting Act 1993, in that it would permit consolidated financial statements not to be prepared if the minority interests in a company unanimously agree.

While on the surface the revision seems reasonable, we have some difficulty in understanding why minority interests would or ever should agree to such a proposal, given that for them the entity in which they have invested is not an in-substance economic extension of another entity, as it may be where full ownership exists, but rather the only entity to which they can have recourse in the event of that entity getting into economic difficulties. Also, unless national legislation permits, what redress to majority shareholders would minority interests have if they do not unanimously agree and consolidated financial statements are still not prepared?

We suggest that the most efficient solution to these kinds of issues is to simply apply the paragraph only to wholly owned subsidiaries.

As for criterion (d), it should probably be deleted, as it is not necessary (its content is covered by the combination of paragraphs 7 and 8 operating together).

Question 2

The Bank agrees with this proposal.

Question 3

If the purpose of these proposals is to provide investors with information on investment costs or the recovery of investment costs, or to provide them with some capacity to make comparisons between the original cost of investments and their current valuations, then we doubt whether the proposed requirements are the most useful or meaningful way of achieving these objectives. Rather, such goals are probably best met using a tailor-made disclosure framework.

Also, since the legal entity and group financial statements of a reporting entity are always presented together, then the objective of attempting to achieve consistency in the accounting bases used for the preparation of these two types of financial statements is not only valid, but also highly desirable and relevant. This is especially so if it helps to avoid any confusion that is likely to arise in the minds of investors about the meaning of the potentially large differences in the portrayal of the same reporting entity's equity position were different accounting bases to be used.

Using consistent accounting bases is also likely to minimise compliance costs.

Conceptually we consider that using the equity method of accounting for investments in subsidiaries and associates in a reporting entity's "separate financial statements" best provides for consistency with the accounting basis used for consolidations.

Paragraph 13

On the proposed paragraph 13 of IAS 27, if there is no binding agreement to sell a subsidiary within a year, then we think it would be imprudent not to require consolidation in this situation. Only if such a binding agreement does exist should the sale be accounted for as a current asset. However, since in the latter circumstances the sale is most likely to occur at a fixed price at an agreed time in the future, then even in terms of IAS 39 provisions the asset would probably have to be accounted for as an held-to-maturity investment, the result being that fair value measurement should generally not enter the picture.

Accordingly, the basis for incorporating paragraph 13 into IAS 27 is not clear, and we suggest that it should either be deleted from the standard, or revised on the basis of the above discussion.

IAS 28 Accounting for Investments in Associates

The Bank supports the use of the equity method of accounting for associates in investors' "separate financial statements", for the same reasons discussed in relation to question 3 of IAS 27 given above.

With respect to the issue of the accounting for a temporary acquisition of an investment in an associate, as contained in the revised paragraph 8 of IAS 28, our views and suggested remedies on this issue are the same as those mentioned above on the revised paragraph 13 of IAS 27.

Question 1

We consider that it is probably not appropriate to allow the associate investments of "venture capital organisations" to be accounted for on a basis different to that of the equity method - almost by definition, any equity investments made by such organisations are unlikely to be amenable to reliable valuation.