



Accounting Alert

A Focus on Technical Accounting Issues - Issue Number 5

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Registration under the Companies Act 1993

All companies which did not reregister under the Companies Act 1993 by 30 June 1997 were automatically deemed to have been reregistered on 1 July 1997.

Some of the effects of reregistration are as follows:

1. Financial statements with balance dates before reregistration date should be prepared under the Companies Act 1955, whilst companies which have been registered or reregistered under the Companies Act 1993 by balance date are required to produce their financial statements in compliance with the new Companies Act 1993.

The only disclosure difference between financial statements under the two Companies Acts is that the par value shares under the old Act become no par value shares under the new Act. Whilst par value shares may give rise to a share premium reserve, the full proceeds of a share issue is credited to share capital under the new regime. In the year of change it is therefore necessary to transfer any share premium reserve to share capital.

2. Annual reports which are signed after reregistration date must comply with s211 of the Companies Act 1993. Whilst some of the s211(1) reporting requirements are repetitive of FRS-9 minimum disclosure requirements, the other disclosures may be reported outside of the financial statements (which form a part of the Annual Report).

The disclosures include:

- particulars of entries in the interests register
- remuneration of directors and former directors
- number of employees and former employees who received remuneration and other benefits greater than \$100,000 (to be disclosed in bands of \$10,000).

S211(2) requires all of the information required under s211(1)(d) to (j) to be provided in relation to the company's subsidiaries. It follows inter alia, that the remuneration of directors of subsidiaries (even if they are not directors of the parent) must be disclosed.

There is an exemption from the disclosure requirements if there is unanimous agreement by the shareholders that the annual report need not include them (S211(3)).

3. The solvency test will need to be satisfied before any distributions are made including:

- paying dividends;
- allowing shareholders to participate in a discount scheme;
- altering a constitution to cancel or reduce shareholders' liability;
- acquiring its own shares;
- redeeming its shares;
- giving financial assistance for the purchase of its shares; and
- amalgamating with one or more other companies.

For further details of the solvency test refer to issue No 3 of Accounting Alert where we considered the implications of the solvency test.

4. A company may now purchase its own shares or provide financial assistance for the purchase of its shares if it is permitted to do so by its constitution and providing the relevant requirements of the Act are met.

5. A company may provide financial assistance for the purchase of its own shares provided the requirements of the Act are met.

6. Directors' duties are more formalised. Resolutions and certificates will be required for many events such as issuing or repurchasing shares and distributions. For further background on directors' duties refer to issue No 4 of Accounting Alert.

FRS-33: Disclosure of Information by Financial Institutions

Financial institutions represent a significant and influential sector of economic activity, are susceptible to greater financial risks, and have a broad range of stakeholders relying on their financial statements. To recognise these unique attributes a new accounting standard was released by the Institute in May governing specific disclosure requirements for financial institutions.

In this article, we discuss the reasons for and the impact of the new standard.

Why has a separate standard for financial institutions been developed?

Most individuals and organisations make use of financial institutions in one way or another, for example, as depositors, borrowers, investors, or as users of payments services. Hence there is a wide range of stakeholders dependent upon consistent and responsible reporting.

A financial institution is also exposed to various types of financial risk, such as that arising from counterparty failure, funding and asset concentrations, interest rate movements, changes in other market prices, and risks arising from an inability to meet obligations as they fall due (liquidity risk). Although other entities have exposures to these risks, the magnitude of these risks for financial institutions is generally greater. Financial institutions, due to their nature, are generally more highly geared than other commercial entities, hence their financial risk is far greater.

A separate standard to cater to the specialised nature of the operations and risks of financial institutions was therefore deemed necessary.

To whom does the statement apply?

FRS-33 defines a financial institution as "... any entity whose principal activity is to obtain funds with the objective of lending or investing in financial assets other than equity instruments ...".

Typical examples of financial institutions include banks, building societies, credit unions, finance dealers and friendly societies.

The definition excludes general insurers, life insurers, superannuation schemes and entities which are wholly funded and controlled by a related party. It also excludes entities which raise funds principally for investment in physical assets such as real estate, or plant and equipment and rather refers to investment in 'financial' assets (eg loans, advances, investments in securities).

Financial institutions must comply with the requirements of FRS-33 in the preparation of general purpose financial reports covering periods commencing on or after 1 April 1997. This standard does not apply to interim general purpose financial reports, but it does apply to half yearly reports prepared by registered banks in accordance with reporting requirements established by the Reserve Bank.

What are the key disclosure requirements?

FRS 33 expands on the disclosure requirements of FRS 9: Information to be Disclosed in Financial Statements and FRS 31: Disclosure of Information about Financial Instruments.

Accounting Policies

FRS 33 specifically requires disclosure of all material accounting policies for financial instruments to disclose the bases for recognising revenues and expenses, for recognising and valuing financial instruments, and for treating unrecognised financial instruments. In particular the standard requires disclosure of the policies for classifying and accounting for impaired assets and the basis of determining specific and general provisions. The standard also requires disclosure of the treatment of commodity instruments, funds under management and other fiduciary duties.

Statements of financial performance and financial position

Minimum disclosures for the statement of financial performance are specified. In particular interest revenues and expenses are to be disclosed for a number of categories including for impaired assets. Write-downs and movements in provisions are also required to be disclosed by class of impaired asset.

Disclosure of assets and liabilities in the broad order of liquidity is required in the statement of financial position. The classes of assets and liabilities are specified in the standard and reclassifications between investment and other categories of assets together with the impact on the surplus before taxation are required to be disclosed. Separate disclosure is required of general provisions and the priority of liabilities is also required to be disclosed.

Risk

Similar disclosures to those required by FRS 31 are required by FRS 33. These include the policies for the management of as well as the financial institution's exposure to various risk types such as liquidity, currency, interest rate and credit risk.

In addition to disclosing the fair value of assets, further information is to be disclosed regarding the quality of impaired and past due assets including the specific provisions and movements in

those provisions for each class of impaired asset. Concentrations of credit risk is also required to be disclosed by customer industry or economic sector and geographical areas. Specific disclosure of concentrations of credit risk with individual counterparties or groups of related counterparties in excess of 10% of equity is required.

Concentrations of funding by customer industry or economic sector, geographical areas and product is also required to be disclosed.

Financial institutions are required to disclose the nature and quantification of their involvement in funds management, securitisation, custodial and trust activities as well as the nature of any arrangements which exist to separate the business risk of these activities from other activities.

Comparatives

Comparatives are not required in the first period of application of the standard for items not previously disclosed.

Summary

FRS 33 by specifying minimum industry-specific disclosures is an important step forward in ensuring the comparability of reporting by financial institutions. We look forward to the next step in the process - the resolution of the measurement and recognition issues associated with financial assets and financial liabilities.

Framework for differential reporting

The Framework for Differential Reporting has been revised to clarify the criteria an entity must meet in order to qualify for the financial reporting exemptions available under the framework. In particular the thresholds of the size criteria have been significantly increased meaning that more entities should now qualify for the exemptions. The revised framework is applicable for periods ending on or after 31 December 1997 but may be applied immediately with appropriate disclosure of the early adoption.

The Framework for Differential Reporting was developed in recognition of the fact that the benefits of financial reporting should exceed the costs of compliance. Differential reporting allows entities in different circumstances to differ in the financial reporting disclosures made and the accounting practices adopted. The framework outlines several criteria which are used to determine whether an entity should comply fully with all financial reporting requirements or be able to take advantage of the exemptions outlined in each financial reporting standard.

An entity will qualify for the exemptions if it does not have publicly accountability and:
i) at balance date, there is no separation between the entity's owners and its governing body; or
ii) the entity is not large.

Public Accountability

An entity is publicly accountable if the entity:

- is (or was) an issuer in terms of the Financial Reporting Act 1993; or
- if the entity has the coercive power to tax, rate or levy.

If an entity is publicly accountable it does not qualify for the differential reporting exemptions.

Where the parent of a group is an issuer, the group is an issuer and is deemed to have public accountability. A group is not considered publicly accountable however solely by reason of a subsidiary or associate being publicly accountable.

Separation Between Owners and Governing Body of an Entity

Where every owner of an entity is also a member of the entity's governing body there is no accountability requirement between the governing body and the owners. If the entity is not publicly accountable then the entity qualifies for the differential reporting exemptions.

The framework now makes it clear that government owned entities such as Local Authority Trading Enterprises, Crown Entities, State-owned enterprises or government departments do not qualify for differential reporting exemptions unless they qualify on the basis of size. The public is considered to have a beneficial interest in these types of entities and in many cases public funds have been indirectly provided to such entities through taxes, rates or levies. Therefore where the parent or ultimate controlling entity has the coercive power to tax, rate or levy to obtain public funds, the entity is not considered to qualify for differential reporting exemptions.

The ability of an entity owned by a trust to qualify for differential reporting exemptions has been also been clarified in the revised framework. For a trust to meet this criteria, all beneficiaries must be trustees as it is the beneficiaries who have the beneficial interests in the entity and are therefore the 'owners' as defined in the framework.

Size

The thresholds for determining whether an entity is 'large' have been increased. An entity is now 'large' if it exceeds any two of the following:

- total revenue of \$5.0 million (previously \$2.5 million)
- total assets of \$2.5 million (previously \$1.5 million)
- employees - total employees comprise the number of full-time equivalent persons in the paid employment of the entity, calculated on an annual basis (previously included unpaid employees).

Other Matters

Other matters clarified by the revised framework include the following:

Selective application of available exemptions

Qualifying entities may selectively apply the provisions of financial reporting standards from which they are exempt under the Framework for Differential Reporting where this will not affect the recognition or measurement of revenues, expenses, assets or liabilities.

Where a qualifying entity discloses information for which there is an exemption in accordance with the Framework for Differential Reporting, it will not be compelled to comply fully with the relevant financial reporting standard. If a qualifying entity chooses to give any disclosure from which it is exempt, the entity must make the disclosure in accordance with the relevant standard.

Exempt Companies

Financial statements of 'exempt' companies (under the Financial Reporting Act 1993) may be prepared in accordance with the framework, provided the requirements of the Order in Council under section 12 of the Act continue to be met.

(A company is 'exempt' for the purposes of the Financial Reporting Act 1993 if

- total assets did not exceed \$450,000;
- turnover did not exceed \$1,000,000; and
- it is not a subsidiary and has no subsidiaries.

The financial statements of exempt companies must comply with the Order in Council).

Compliance with GAAP

The framework has now been formally approved by the Accounting Standards Review Board indicating that differential reporting is consistent with the legal requirements for financial reports to comply with generally accepted accounting practice (GAAP). However, where application of differential reporting results in the financial reports not giving a fair presentation, then additional information and explanations will be required in the financial report to give a fair presentation. This circumstance is expected to be rare.

Changes in qualification status

When the size criteria have been amended (which is the present position) an entity may apply the revised size criteria in the first year of application and qualify immediately for differential reporting exemptions.

If an entity was 'large', it has to cease to be 'large' for two consecutive reporting periods, before becoming a qualifying entity.

If an entity no longer qualifies for differential reporting exemptions, it must cease immediately to apply the exemptions.

Changes in Disclosure Requirements

New or revised financial reporting standards each now include a paragraph advising of the differential reporting exemptions available. The framework contains a list of these exemptions by standard which was current at the time of issue. The following are changes to the exemptions available prior to the reissue of the framework:

SSAP-3: Accounting for Depreciation

Revalued assets are not covered by the exemption which allows qualifying entities to adopt the same rate of depreciation for financial reporting as for income tax purposes.

SSAP-8: Accounting for Business Combinations

The Crown is no longer exempted from complying with SSAP-8.

SSAP 12: Accounting for Income Tax

Qualifying entities are granted full exemption from SSAP 12. The appendix to the revised framework now explains that an entity is not required to use the liability method of accounting for income tax but may use the taxes payable method. If an entity does choose to tax effect account however it must do so in accordance with SSAP 12. No disclosures other than the accounting policy are required whichever method is adopted. If disclosures are made voluntarily then they must be in accordance with the standard.

