



Victoria University
of Wellington, New Zealand
Te Whare Wananga o te
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Aotearoa

centre for **Accounting,**
Governance &
Taxation Research

**THE CASE FOR THE USE OF INTERNATIONAL
FINANCIAL REPORTING STANDARDS
IN NEW ZEALAND:
A BRIEFING PAPER PREPARED ON BEHALF OF
THE NEW ZEALAND SECURITIES COMMISSION
Working Paper No. 11**

Keitha Dunstan

Director

Centre for Accounting, Governance and Taxation Research
Victoria University of Wellington

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Centre for Accounting, Governance and Taxation Research
School of Accounting and Commercial Law
Victoria University of Wellington
PO Box 600
Wellington
NEW ZEALAND

Phone 64 4 4636957 Fax 64 4 4635076
<http://www.accounting-research.org.nz>

Executive Summary

The objective of this paper is to examine the issues pertinent to the consideration of the proposal made by the Accounting Standards Review Board (ASRB) that New Zealand adopt the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). The purpose of this examination is to provide input to the New Zealand Securities Commission (the Commission) to assist them in their deliberations on making recommendations on the future development of the financial reporting infrastructure for New Zealand's securities markets.

Similar to securities regulators across the world, the Commission has an interest in promoting a strong securities market where the financial reporting framework and its supportive infrastructure results in high quality, transparent and comparable financial reports. There are four identifiable components of the infrastructure that drive the quality of financial reporting in New Zealand.

- 1) Financial reporting standards
- 2) Corporate governance
- 3) External audit
- 4) Enforcement.

The scope of this paper is limited to an assessment of the first of these components financial reporting standards; with an emphasis on an analysis of the consequences of any decision to adopt IFRS in New Zealand. The paper provides a framework for assessing the viability of the IASB reporting framework as an acceptable standard-setting regime for New Zealand that is based on:

- 1) The quality of IFRS standards
- 2) The quality of the IASB standard-setting process
- 3) The extent of international acceptance of IFRS.

Our examination of each these aspects suggests:

- 1) The quality of IFRS standards

There is evidence that IFRS have improved in quality and will continue to improve through the IASB's current improvements project. The recent policy of convergence with the financial reporting standards issued in the United States by the Financial Accounting Standards Board (FASB) inspires further confidence in continuing improvement. Further, the IFRS standards take a "principle-based" approach, with standards being developed based on an underlying "conceptual framework", which is consistent with the recommendations of some commentators in a post "Enron affair" environment. There is also empirical evidence, which supports the conclusion that financial reports prepared using IFRS are at least as informative as those prepared using US Generally Accepted Accounting Practice (GAAP) and other countries domestic GAAP.

- 2) The quality of the IASB standard-setting process

The IASB is broadly representative with 14 members from nine different countries and is financed from a number of different sources. The 'due process' for standard-setting is designed so that constituents have opportunity to participate in the process. A quality financial reporting standard-setting framework should be open, neutral and independent. The processes of the IASB are consistent with best practice as it exists for the major financial reporting standard-setting bodies across the world.

- 3) The extent of international acceptance of IFRS

The extent of adoption of IFRS varies across the world although there is a clearly identifiable trend towards increasing adoption. A number of countries, soon to include the European Union and Australia, have adopted IFRS in their entirety. Others allow the use of IFRS for companies, which are foreign registrants. In other major jurisdictions where IFRS are not yet adopted, namely the United States and Canada, there are policies of convergence between their domestic GAAP and IFRS. There is also empirical evidence of a trend for multinational companies from many jurisdictions to voluntarily adopt IFRS.

Our conclusion, therefore, is that the IASB reporting framework would be an acceptable standard-setting regime for New Zealand. However, any decision to switch to this regime must be driven by a cost/benefit analysis of the adoption of IFRS in New Zealand. Our analysis addresses the following aspects:

- 1) Direct compliance costs
- 2) Access to capital and impact on economic growth
- 3) Standard-setting costs
- 4) Enforcement issues
- 5) Other issues.

1) Direct compliance costs

One component of compliance costs related to a switch to IFRS are the costs that will be incurred initially by preparers, users, auditors and regulators in re-training themselves on the requirements of the new reporting framework and planning and preparing for the transition. We have identified a number of instances of differences between existing Financial Reporting Standards (FRS) and IFRS that would require re-training. However, in our opinion these differences are relatively minor and will be diminished even further given the IASB's improvements project and the policy of convergence with the FASB standards in the US. Further, it should be noted that the proposed policy of international convergence set out by the Financial Reporting Standards Board (FRSB) in ED 92 would in the long-run result in the minimisation or even complete removal of these differences. In which case, New Zealand firms will ultimately be required to make the changes whether a regime shift is adopted or not.

A second, and important, source of concern regarding compliance costs is the possible economic consequences for New Zealand firms of having to change their existing set of accounting policies and the related set of financial reporting decisions to fit the new framework. These costs may be significant where a firm is forced to change an accounting policy that suits its existing portfolio of accounting policy choices which could ultimately impact on the investment decisions made by those firms. These costs will vary across firms and are difficult to estimate.

2) Access to capital and impact on economic growth

There is a body of empirical research that supports the conclusion that strong securities markets have improved access to capital, and in the long-term have greater economic growth. There is also limited evidence which links the quality of financial reporting to the strengthening of securities markets and hence logically to improved access to capital and greater economic growth. However, research that specifically provides evidence of an association between adoption of IFRS and such improvements has been limited to instances where IFRS are adopted in developing economies or in low quality reporting regimes.

Therefore, there is no support for an argument that the adoption of IFRS in New Zealand will lead to improved access to capital or greater economic growth. However, it is arguable that in the longer run if New Zealand, as such a small component of the international capital market, sets out alone with a unique financial reporting framework which departs from the international norm and in the shorter term from Australia it will be regarded with suspicion. This is likely to lead to the perception that our capital market has higher risks. This would result in a higher cost of capital for New Zealand firms, and ultimately, could lead to a decrease in economic growth.

3) Standard-setting costs

A switch to IFRS may reduce the costs for New Zealand of operating a stand alone financial reporting standard-setting body. However, we contend that the New Zealand policy of "sector neutral" financial reporting standards and the need to retain a body that can adequately represent the interests of the New Zealand constituency make it necessary to retain an independent standard-setting body. Despite the 'due process' of the IASB, New Zealand constituents will find participation in the due process on an international level more difficult than they have experienced domestically in New Zealand thus far. Therefore, while we expect the potential standard-setting costs reduction may be minimal.

4) Audit and Enforcement issues

Many commentators contend that the adoption of one set of international financial reporting standards is doomed to failure unless there is a single international body to enforce the application of these standards internationally. However, in a developed country such as New Zealand, which already has

high quality reporting standards, and arguably a high quality financial reporting infrastructure, the absence of an international regulatory body should not represent an impediment to the adoption of IFRS. However, it is important that New Zealand retains its commitment to developing the other aspects of the financial reporting infrastructure namely, corporate governance, external audit, and enforcement.

5) Other issues.

New Zealand has been a world leader in the reform of public sector financial reporting. A cornerstone of these developments has been our commitment to sector-neutral financial reporting standards. This represents a potential impediment to the adoption of IFRS, as they focus on the private sector in isolation. Australia intends to address this problem by issuing standards that contain the relevant IFRS and where necessary, augment this with further public sector specific content. An obvious problem with such an approach is that standards could become complicated and internally inconsistent. We suggest that New Zealand follows the Australian proposal, however, in recognition of the potential problems, we believe that it needs to maintain a strong and independent financial reporting standard-setting body.

A further issue that has been discussed is whether IFRS should be adopted for listed companies only. We conclude that a simple listed versus unlisted company differentiation is unjustified and that any differential reporting allowances should be justified on a conceptual basis. New Zealand already has an exempt companies regime that could be applied or further work could be done on a conceptual justification for differential reporting, such as that which exists in Australia with their 'reporting entity' concept.

Additional issues that favour New Zealand's adoption of IFRS are:

- Our commitment to the New Zealand Australia Closer Economic Relations Trade Agreement 1983 (CER) and the obligations to work toward harmonisation between New Zealand and Australia set out in the Financial Reporting Act (FRA) 1993. These arrangements create pressure to adopt IFRS consistent with Australia's decision to do so.
- The political consideration of being able to gain an "early mover" advantage which may have a positive effect on the credibility of New Zealand standard-setters and our financial reporting infrastructure.

This paper also identifies an opportunity for further "harmonisation" of financial information reporting requirements applicable to issuers of securities. Compliance costs for issuers would diminish if the separate financial information reporting requirements of the Securities Regulations 1983 for Prospectuses were replaced by requirements for compliance with GAAP as defined under the FRA.

CONCLUSION AND RECOMMENDATIONS

The analysis presented in this paper supports the conclusion that the IASB financial reporting regime is a viable alternative to New Zealand's existing financial reporting regime. Further, our cost/benefit analysis suggests that there will be long-term net benefits for New Zealand from adopting IFRS. We recommend, therefore, that the Commission:

- 1) Supports the recommendation made by the ASRB for New Zealand to adopt IFRS.
- 2) Supports the policy of the ASRB to adopt IFRS in a manner which preserves their commitment to sector-neutral financial reporting standards for New Zealand
- 3) Encourages an adoption date in line with that of Australia and the European Union, or at least as close as is reasonably possible to that date.
- 4) Supports the maintenance of a strong, independent, and representative standard-setting body in New Zealand, which is funded by a number of different sources.
- 5) Considers replacement of the financial information disclosure requirements of the Securities Regulations 1983 with the requirement for compliance with GAAP, as defined under the FRA, for Prospectuses.

Further, while outside the scope of this paper we recommend that the Commission continue to foster developments in the other three aspects of the financial reporting infrastructure, that is, corporate governance, external audit, and enforcement.

Key to Acronyms Used

AASB	Australian Accounting Standards Board.
ASRB	Accounting Standards Review Board.
ASX	Australian Stock Exchange.
CER	New Zealand Australia Closer Economic Relations Trade Agreement 1983.
FASB	Financial Accounting Standards Board.
FEE	European Federation of Accountants
FRC	Financial Reporting Council.
FRA	Financial Reporting Act 1993.
FRS	Financial Reporting Standards.
FRSB	Financial Reporting Standards Board.
GAAP	Generally Accepted Accounting Practice.
IAASB	International Auditing and Assurance Standards Board.
IASB	International Accounting Standards Board.
IASC	International Accounting Standards Committee.
ICANZ	Institute of Chartered Accountants of New Zealand.
IFAC	International Federation of Accountants.
IFAD	International Forum on Accounting Development.
IFRS	International Financial Reporting Standards.
IOSCO	International Organization of Securities Commission.
ISA	International Statements on Auditing.
NZSA	New Zealand Society of Accountants.
NZSE	New Zealand Stock Exchange.
SEC	The Securities Exchange Commission.
SSAP	Statement of Standard Accounting Practice.

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1 Introduction

The veracity of corporate financial reporting and its regulation has recently received unprecedented international scrutiny in the light of major corporate collapses in the United States and elsewhere¹. These apparent breaches of the integrity of the applicable financial reporting and regulatory frameworks have provided additional fuel to the debate regarding the need for uniform and high quality reporting standards internationally. Further, the increasing globalisation of economic activity has increased demand for those standards to be comparable internationally. These forces have increased the momentum towards international acceptance of the International Financial Reporting Standards (IFRS)² developed by the International Accounting Standards Board (IASB), and have stimulated financial reporting standard setters and securities regulators internationally to review their positions regarding the adoption of IFRS. The Accounting Standards Review Board (ASRB) in New Zealand has recently recommended that New Zealand follow the moves by the European Union and Australia by committing to the adoption of IFRS. The objective of this paper is to examine the issues pertinent to the consideration of the proposal made by the Accounting Standards Review Board (ASRB) that New Zealand adopt the IFRS issued by the IASB. The purpose of this examination is to provide input to the New Zealand Securities Commission (the Commission) to assist them in their deliberations on making recommendations on the future development of the financial reporting infrastructure for New Zealand's securities markets.

Section two of this paper provides an outline of the theoretical relationship between financial reporting quality and the strength of securities markets in the New Zealand regulatory context. A description of the financial reporting status quo in New Zealand is provided in section three. This includes an explanation of the relationship between the three principal bodies involved in developing and issuing financial reporting standards in New Zealand: the ASRB, the Financial Reporting Standards Board (FRSB) and the New Zealand Stock Exchange (NZSE). Section four provides an account of the moves towards international convergence/harmonisation³ of financial reporting standards and outlines the role played by the IASB to date. The key analysis of this paper is provided in sections five and six which provide an evaluation of the proposal to adopt IFRS in New Zealand. Section five sets out a framework for evaluating whether the IASB reporting framework is viable as an acceptable standard-setting regime for New Zealand⁴. This is a three-stage analysis based on:

- 1) The quality of IFRS standards
- 2) The quality of the IASB standard-setting process
- 3) The extent of international acceptance of IFRS.

¹ Notable corporate collapses include from the United States, Enron, WorldCom and Xerox and from Australia, HIH, One-Tel, Harris Scarfe, Pasmenco and Ansett.

² Standards issued by the predecessor of the IASB, the International Accounting Standards Committee (IASC) were named International Accounting Standards (IAS). For simplicity, all references to IFRS in this paper, will refer to the accounting standards issued by both the IASC and the IASB.

³ This paper adopts the definitions of convergence and harmonisation provided by the FRSB in Exposure Draft (ED 92) (2002) "International convergence means working with other standard setting bodies to develop new or revised financial reporting standards that will contribute to the development of a single set of accounting standards for world-wide use. International harmonisation...refers to a process which leads to those standards being made compatible with the standards of international accounting standards to the extent that this would result in high quality standards" para. 5.2..

⁴ This framework is developed from Richardson and Hutchinson (1999).

The analysis is extended in section six, which provides a cost/benefit analysis of the adoption of IFRS in New Zealand under five categories.

- 1) Direct compliance costs
- 2) Access to capital and economic growth
- 3) Standard-setting costs
- 4) Enforcement issues
- 5) Other issues.

Our conclusion and recommendations are set out in section seven.

2 Financial Reporting Standards and Securities and Capital Market Regulation in New Zealand

The Commission was established under the Securities Act (1978) and states its purpose as being, to foster capital investment in New Zealand through “strengthened confidence in New Zealand’s capital markets, both in New Zealand and overseas, by promoting:

- the efficiency of these markets;
- the integrity of these markets; and
- the cost-effective regulation of these markets”⁵.

Similar to securities regulators across the world, the Commission has an interest in promoting a strong securities market where the financial reporting framework and its supportive infrastructure results in high quality, transparent and reliable financial reports.

Black (2001)⁶ defines a strong securities market as one that “rests on a complex network of legal and market institutions that ensure that minority shareholders (1) receive good information about the value of a company’s business and (2) have confidence that a company’s managers and controlling shareholders won’t cheat them out of most or all of the value of their investment” (p.781). He also claims that in the absence of a strong securities market, firms will be limited in their sources of capital with an inefficient emphasis on internal financing or bank financing with the result that the cost of capital will be higher and investment will be discouraged, resulting in lower economic growth.

Black (2001) finds support for his claims in a body of empirical evidence, which identifies a correlation between strong capital markets and growth. Kaufman et al. (2000) report that several measures of “rule of law” and “Governance” were positively related to per capita GDP. Using social infrastructure as a proxy for governance, Hall and Jones (1999) find a similar association. Black also cites two studies which provide evidence that capital market strength, as measured by liquidity

⁵ See www.sec-com.govt.nz

⁶ Black (2001) stops short of recommending the adoption of IFRS, however, he does note that the IASC is not far from completing a workable set of International Accounting Standards.

and prices is an efficient predictor of economic growth (see Henry, 2000; Levine and Zervos, 1998).

An extension of this reasoning would be that firms operating in weaker securities markets would have impaired access to capital from other jurisdictions. Researchers have found evidence that firms from jurisdictions with lower quality legal laws and weaker market institutions are perceived to present greater risks to investors and face a higher cost of capital (Leuz and Verrechia, 2001). There is also evidence that countries with weaker securities markets face less active markets and lower economic growth than jurisdictions with stronger securities markets (Francis et al, 2000). From the perspective of New Zealand, such evidence provides a clear mandate for the Commission to strive for the strengthening of our securities market through high quality legal and market institutions.

Black (2001) sees the provision of “good information about the value of a company’s business’ as an essential characteristic of a strong securities market. The United States Securities Commission (2000) similarly state that “the only way to achieve fair, liquid and efficient capital markets worldwide is by providing investors with information that is comparable, transparent and reliable”(p.1). This contention is supported by empirical research that provides evidence that countries with strong investor protection laws, and more transparent and timely financial reporting and more extensive auditing have more developed markets and higher firm valuation (La Porta et al., 2002 and Francis et al., 2002).

The question then becomes, what financial reporting infrastructure will ensure the provision of such information⁷? The components of the existing New Zealand infrastructure are depicted in Figure 1.

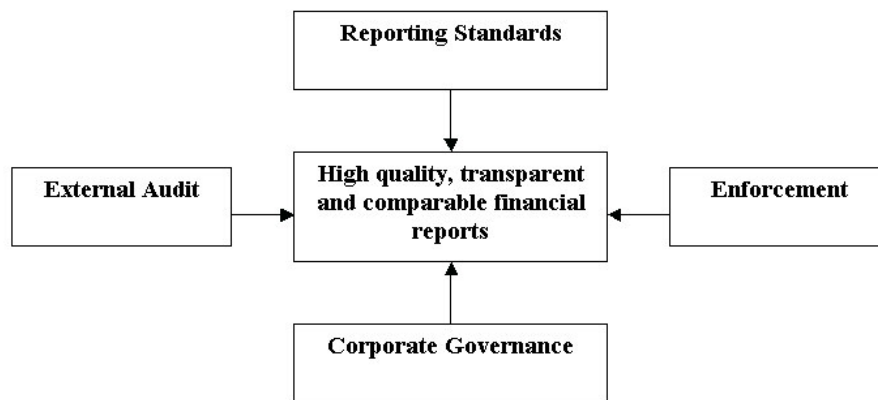


Figure One
The Drivers of High Quality, Transparent and Comparable Financial Reports

⁷ The Institute of Chartered Accountants of New Zealand’s “Statement of Concepts fro General Purpose Financial Reporting”, June 1993 describes four qualitative characteristics of information, relevance, understandability, reliability and comparability.

- 1) Financial reporting standards
- 2) Corporate governance
- 3) External audit
- 4) Enforcement

All four aspects of this infrastructure must operate together to ensure that high quality, transparent and comparable financial reports are prepared. The first component, financial reporting standards represent the codification of financial accounting practices that entities are required to comply with⁸. The corporate governance mechanisms that exist within firms provide the internal control system that ensures that the entity discharges its responsibilities under the applicable laws and regulations. The external audit process represents the mechanism through which an independent assessment of the firm's compliance is attained. The final, but essential, mechanism is that of the regulators who enforce the ultimate compliance with the applicable laws and regulations. It is essential that all four components of the infrastructure perform their respective roles for the quality of financial reporting is to be ensured.

The scope of this paper is limited to an assessment of the first of these components, financial reporting standards, with an emphasis on an analysis of the consequences of any decision to adopt IFRS in New Zealand. However, we emphasise that this analysis should be considered in the context of developments within the other three components. The next section sets out the financial reporting framework that currently exists in New Zealand.

3 The Financial Reporting Status Quo in New Zealand

New Zealand has a well-entrenched tradition of commitment to high quality reporting standards. Most notable is our involvement with the G4+1⁹ that has arguably been the group, which has enabled the internationalisation agenda to be developed to its present stage. Indeed, New Zealanders have long played a leadership role internationally, for example, Professor Ian Ball (Victoria University of Wellington) was recently appointed as CEO of the International Federation of Accountants (IFAC), Mr Warren Allen (Ernst & Young) has been a long standing member (and Chairman) of IFAC's Education Committee and Mr Kevin Simpkins (Office of the Controller Auditor-General of New Zealand) is a member of IFAC's Public Sector Committee.

Presently, there are three principal bodies involved in developing and issuing financial reporting standards in New Zealand. These bodies are the ASRB, FRSB and NZSE. Prior to 1993, a private sector body, the New Zealand Society of Accountants (NZSA), dealt with the regulation of the accounting profession in New Zealand. The NZSA was responsible for the development and issue of financial reporting standards. The Financial Reporting Act 1993 (FRA), introduced a new era in financial reporting in New Zealand. "Standards for financial reporting are now approved outside the accounting profession and these standards have legal backing" (van Zijl, 1994, p.420).

⁸ Financial reporting standards are broader than just the mandatory standards and encompass all aspects of Generally Accepted Accounting Practice (GAAP). This is discussed further in section 3.

⁹ The G4+1 was the name used to describe the liaison group of the IASC with standard setters from the United States, United Kingdom, Australia, Canada and more recently New Zealand.

These approved accounting standards are the Financial Reporting Standards (FRS), which form the cornerstone of GAAP in New Zealand.

The FRA is the primary statute governing Generally Accepted Accounting Practice (GAAP) including the establishment of FRS in New Zealand. Section 10 of the FRA requires all Reporting entities to prepare financial statements in accordance with section 11. Section 11 requires all financial statements to comply with generally accepted accounting practice (GAAP) and to show a true and fair view. Reporting entities are defined as Issuers¹⁰, companies (other than exempt companies as defined - primarily where companies have assets that are less than \$450,000 and with turnover less than \$1m) and any other person that is required by any Act to comply with the FRA as if it were a Reporting entity. This latter provision captures most of the public sector entities that choose to be Reporting entities.

Compliance with GAAP is defined in Section 3 of the FRA as, "compliance with applicable Financial Reporting Standards (FRS) (approved by the ASRB) and in relation to matters for which no provision is made in applicable financial reporting standards and that are not subject to any applicable rule of law, accounting policies that are appropriate to the circumstances of the Reporting entity; and have authoritative support within the accounting profession in New Zealand."

Authoritative support within the accounting profession in New Zealand is defined within paragraph 4.5 of the ICANZ 'Explanatory Foreword to General Purpose Financial Reporting' to include:

- FRS's and Statements of Standard Accounting Practice (SSAP)'s¹¹ and interpretations and guidance notes thereon issued by ICANZ
- the Statements of Concepts issued by ICANZ
- exposure drafts of FRS's issued by ICANZ
- technical practice aids, technical practice bulletins and research bulletins issued by ICANZ
- accounting standards published by the Australian AASB
- IFRS's issued by the IASB
- accounting and financial reporting standards issued by other recognised international standard setters
- practice widely accepted as appropriate and prevalent for the industry or sector concerned.

It is notable that ICANZ already considers IFRS's on topics where there is no applicable FRS as having authoritative support as part of GAAP.

Section 22 of the FRA establishes the ASRB with the primary function of reviewing and approving proposals for financial reporting standards (FRS) as submitted to it by the NZSA (now ICANZ) or other parties. Other functions of the board are to "make recommendations in relation to submission of standards to it for approval, give

¹⁰ The definition of Issuers in the FRA is not the same as the definition in the Securities Act 1978 - eg, Issuers for FRA purposes includes banks. Issuers, as defined in section 2 of the Securities Act 1978, exempts some entities including banks, the Crown and a few other public sector entities from compliance with the Securities Act.

¹¹ SSAP's are accounting standards that have been issued by the FRSB but not yet approved by the ASRB. They are, however, deemed to be part of GAAP under Section 3 of the FRA and therefore have authoritative support within the accounting profession in New Zealand.

directions as to the financial reporting policies that have authoritative support within the profession in New Zealand, encourage the development of financial reporting standards including standards for different classes of reporting entity, and to liaise with the Accounting Standards Board of Australia with a view to harmonising New Zealand and Australian financial reporting standards (FRA, section 24)” (Van Zijl, 1994, p. 423).

The FRSB is a board of the Institute of Chartered Accountants of New Zealand (ICANZ) whose members are appointed by the Council of the Institute. The FRSB is not only responsible for developing and revising FRS's, but is also responsible for developing alternative sources of authoritative support including the maintenance of the Statement of Concepts for General Purpose Financial Reporting, guidance notes and Technical Practice Aids. This responsibility requires that the FRSB consider all relevant standards issued by the IASB and the Australian Accounting Standards Board (AASB) and other standard setting bodies. The FRSB is also required to ensure that, wherever possible, standards are harmonised with IASB and Australian pronouncements. The FRSB does not have the direct mandate to approve FRS, this is the sole domain of the ASRB.

For companies listed on the New Zealand Stock Exchange (NZSE), there are further reporting requirements over and above those required by the accounting profession and legislation. These are contained in the New Zealand Stock Exchange Listing Rules. Failure to comply with these rules may lead to the companies' shares being suspended from trading (Deegan and Samkin, 2001).

The interaction of these three bodies has resulted in a generally well-accepted and developed financial reporting framework that compares favourably with international best practice. Independent support for this assessment is provided by La Porta et al. (1998). They provide a rating of the quality of accounting standards which ranks New Zealand 8th out of the 49 countries studied. As pointed out by a number of researchers, for example, Spence, (1973), Ball et al. (2000), Francis et al. (2002) a quality of financial reporting framework will only produce high quality, transparent, and comparable financial reports if it is sufficiently supported by appropriate enforcement mechanisms and other political, legal and economic institutions (see section 5.3)¹².

An independent measure of New Zealand's performance more generally, is the Milken Capital Access Index, which is composed of a number of qualitative and quantitative measures of the ability of an entrepreneur to gain access to capital. In 2000, New Zealand ranked ninth out of 81 countries and was scored ahead of Australia, Canada and Germany, which were ranked tenth, eleventh and twelfth respectively (Straszheim, 2000). Obviously, the quality of the financial reporting framework is just one factor, which would be expected to influence this index.

A review of the performance of the existing financial reporting framework fails to identify any obvious deficiencies in terms of international best practice, so one might ask the question, if it is not broken, why fix it? The answer lies in the fact that New Zealand should not be complacent and must continue to be forward looking to ensure

¹² ICANZ (2002) argue that more resources should be made available to the Securities Commission and the registrar of Companies in New Zealand to undertake their enforcement work.

that we are able to maintain our high standing in the long-term. Further, we must accept that New Zealand is a very small player in the global capital market¹³ and cannot afford to ignore the rapid pace of change in the international arena. The next section describes the international momentum towards the international convergence/harmonisation of financial reporting standards.

4 Moves Towards International Convergence/Harmonisation of Financial reporting Standards

The IASB has emerged as the favoured body to set internationally uniform financial reporting standards. We commence with a brief review of its development.

The predecessor of the IASB, the International Accounting Standards Committee (IASC), was first established in 1973. It had a membership of 143 organisations from 104 countries as at January 2000 (Radebaugh and Gray, 2002). In 2001, the committee was reconstituted as the IASB in response to pressure to become more independent of the professional accounting bodies to enable it to work more closely with national standard-setters. The reconstituted IASB is made up of 14 board members from nine different countries.

The IASB's stated objectives are:

1. to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions;
2. to promote the use and rigorous application of those standards; and
3. to bring about convergence of national accounting standards and International Accounting Standards (International Financial Reporting Standards) to high quality solutions.¹⁴

The main features of the IASB, as approved by the IASC Board in November 1999, are that the:

1. IASB would be established as an independent organisation;
2. the organisation would have two main bodies, the trustees and the board, as well as a Standing Interpretations Committee and Standards Advisory Council; and
3. the trustees would appoint the board members, exercise oversight, and raise the funds needed, whereas the board would have sole responsibility for setting accounting standards (Choi, et al, 2002).

In the early years of its existence, the IASC was criticised for being slow and for issuing what were perceived to be weak standards with too many allowable alternative choices to be workable. In effect, the early standards issued tended to allow a choice between most of the methods adopted by the various domestic standard-setters

¹³ The World Federation of Exchanges Statistics 2001, report that New Zealand's market capitalisation of domestic firms at the end of 2001 was US\$17 736.5m as compared to the global market capitalisation of US\$26 610 565.8m i.e. less than .07%.

¹⁴ See www.iasb.org.uk

(Radebaugh and Gray, 2002). They made their first step towards becoming a credible financial reporting standard-setting body when the International Organization of Securities Commission (IOSCO) gave them a limited endorsement in May 2000. IOSCO recommended that its members allow multinational companies to use 30 core IAS for the purposes of cross-border listings and capital raisings. However, IOSCO members were also permitted to require reconciliation of certain items, call for supplementary information, and eliminate some of the options that were available under IAS. Regardless of these early problems, the IASB is now a restructured, independent standard-setter that has widespread support from governments, standard-setting agencies, securities commissions, and professional accounting associations worldwide. The trend towards acceptance of the IASB and its standards is considered further in section 5.3.

Gray (1989) describes a number of pressures that have precipitated the increasing moves towards the international convergence/harmonisation of financial reporting standards. They include growing economic and political interdependence, increasing availability of direct foreign investment, multinational corporate expansion, the impact of technology and the rapid growth of international financial markets. In recent times, these pressures have been increased by a worldwide trend towards deregulation of markets and privatisation of public sector entities. Together these forces have meant that the volume of cross border capital flows and cross border trading and listing has increased significantly with a resultant demand for high quality, transparent and comparable financial reports based on a set of uniform financial reporting standards (GAAP, 2001).

Further pressures for international convergence/harmonisation have been brought to bear since the recent spate of significant corporate collapses, especially those of Enron and WorldCom in the United States. These have subjected the accounting profession, corporate managers and directors and regulators to significant public scrutiny. Capital markets throughout the world saw substantial capitalisation losses that were unprecedented in the absence of obvious economic explanations. In recognition of the serious threat to the credibility of their major corporations, politicians in the United States reacted by establishing a number of Congressional enquiries, and President Bush issued his "Ten-Point Plan" which embodied three core principles: accurate and accessible information, management accountability, and auditor independence (Pitt, 2002). These moves culminated with the United States ultimately enacting into law the Sarbanes-Oxley Act 2002, which introduced many reforms to corporate governance and auditing. This threat to public confidence in the integrity of the financial reporting framework, especially that of the United States, has added momentum to the calls for a high quality international financial reporting framework.

The Asian Economic crisis of 1997/1998 also added extra pressure for the strengthening of an international financial reporting framework. The crisis demonstrated how global markets allow a crisis to erupt and spread much more quickly. This prompted IFAC in conjunction with the World Bank to establish the International Forum on Accounting Development (IFAD). IFAD is intended to provide the means to assist regulators, international financial institutions, investors, and representatives of the accountancy and auditing professions to work together to facilitate the development of accounting capabilities in developing and emerging

markets. IFAD is firmly committed to the international convergence of accounting standards¹⁵.

The IASB has seized the opportunity, under the existing political and economic conditions, to further their lobbying for the adoption of IFRS internationally. In his statement to the US Congressional hearing, The Committee on Banking, Housing and Urban Affairs on February 14, 2002, Sir David Tweedie, the chairman of the IASB, stated that:

The IASB's objective is to work toward a single set of high quality international financial reporting standards, produced in the private sector under principles of transparency, open meetings, and full due process. The international financial markets clearly want a single set of accounting standards that apply worldwide. We have no intention to 'water down' existing standards in any jurisdiction. Instead we plan to build a set of financial reporting standards that are the "gold standard". In pursuit of that goal, we plan to pick the best of available standards produced by national standard setters (Tweedie, 2002, p.13).

Numerous commentators have predicted the inevitability of the adoption of a single set of financial reporting standards worldwide (Radebaugh and Gray, 2002). Epstein and Mirza (1999) predict that, "the international accounting standard setting process... is now poised on the brink of achieving wide-spread legitimacy, which may result, over time, in the IASC (*read IASB*) becoming the premier standard –setter" (p.17).

The FRSB has already committed to the convergence/harmonisation to IFRS. They set out the benefits of convergence and harmonisation in ED 92 as including:

- (a) improving the quality of financial reporting in New Zealand to best international practice;
- (b) increasing the comparability of financial reports prepared in different countries and providing participants in international capital markets with better quality information on which to base investment and credit decisions. It will also reduce financial analysis costs through analysts not having to recast information on a common basis and requiring knowledge of only one set of financial reporting standards rather than several;
- (c) removing barriers to international capital flows by reducing differences in financial reporting requirements for participants in international capital markets and by increasing the understanding by foreign investors of New Zealand financial reports;
- (d) reducing financial reporting costs for New Zealand multinational; companies and foreign companies operating in New Zealand and reporting elsewhere' and
- (e) facilitating more meaningful comparisons of the financial performance and financial position of New Zealand and foreign public sector entities. (Para. 5.8)

¹⁵ See www.ifad.net

The benefits of convergence/harmonisation are also canvassed in a joint publication by the major international accounting firms, “GAAP 2001”.

High quality global accounting standards are needed to improve the ability of investors to make informed financial decisions, thereby leading to a reduction in risk for investors, and ultimately, to a reduction in the costs of capital. Equally important, global standards can improve access to capital markets and reduce costs and the complexity for international companies by reducing or eliminating some of the multiple reporting obligations (p. 4).

“GAAP 2001” suggests an evolutionary approach, where national rules change gradually to enable the proper development of educational, professional and regulatory infrastructures. They describe the wholesale adoption of IFRS as a “big bang” approach which would only be workable in the context of a highly trained accounting profession. It should be noted, however, that they stated this position prior to the recent moves of the EU and Australia. Further, New Zealand could be argued to have a highly trained profession, which is fully able to cope with a “big bang” approach.

5 A Framework For Evaluating the Viability of Proposal to Adopt IFRS

This paper provides a framework for assessing the viability of the IASB reporting framework as an acceptable standard-setting regime for New Zealand that is based on:

1. The quality of IFRS standards
2. The quality of the IASB standard-setting process
3. The extent of international acceptance of IFRS.

5.1 Quality of IFRS Standards

Many jurisdictions, including Canada, have given serious consideration to whether the adoption of US GAAP would be a superior alternative to adopting IFRS. It is arguable that the recent criticisms of the US framework have made the IASB the forerunner as the appropriate body to issue a single set of world wide financial reporting standards. Some commentators see the apparent flaws in the United States financial reporting standards as being driven by their black letter approach which focuses on form rather than substance and therefore encourages the type of creative avoidance witnessed in the Enron affair (Higson, 2002). This contrasts with the IFRS which have been promulgated using a “principle-based” approach with standards deriving from an underlying conceptual framework.

An essential but not sufficient criterion for the adoption of an alternative financial reporting standard regime is that the quality of the financial reporting standards must be of sufficient quality to be considered a viable framework for New Zealand. This test is one of sufficiency and does not require IFRS to be as high or higher quality than the existing financial reporting framework in New Zealand. Commentators on financial reporting often describe a ‘quality’ financial reporting as one where managements discretion to manipulate outcomes is minimised. Therefore financial reporting standards that permit a number of alternative methods are perceived to be lower quality than those with fewer choices. The argument would be if IFRS allow

more diversity of practice than the existing financial reporting framework in New Zealand than any switch in regime would lower the overall level of transparency and disclosure in financial reporting. As discussed in section four, criticisms of the early work of the IASC tended to revolve around the high levels of flexibility that were ingrained in international financial reporting standards. The more recent work of the IASB, including its current improvement program has or is in the process of reducing that flexibility. In May 2002, the IASB issued an exposure draft, "Improvements to Existing International Financial Reporting Standards". The exposure draft proposed numerous improvements to 12 of its 34 active standards, through increased convergence and the removal of options available under standards. Proposed changes include, the prohibition of the last in first out (LIFO) as an inventory valuation method and the recognition of items of expense or income as extraordinary items.

Van Zijl and Walker (2001) provide a detailed review of New Zealand's convergence towards the IASB financial reporting framework. Appendix 1 provides a reproduction of the authors' summary of the incompatibilities between the New Zealand and international pronouncements¹⁶. There are a number of differences, which if they prevail, would result in changes in practice. Most of the differences are trivial and involve IFRS standards that are being examined under the current improvements project. Changes that could have more significant impact are where the adoption of IFRS would result in new accounting standards in areas which are not currently covered by FRS.

Of most concern to New Zealand companies will be that IAS 38 "Intangible Assets" prohibits the recognition of internally generated brands, mastheads, publishing titles, customer lists and similar items and revaluations of intangible assets are only permitted where there exists an active market for the asset. This will arguably result in some firms having to derecognise and/or reverse previous revaluations of intangibles such as brand names and mastheads¹⁷. However, it must be noted that the FRSB has issued ED 87 Accounting for Intangible Assets, which has accounting requirements identical to IAS 38. Therefore the compliance costs for New Zealand companies have just been moved forward. This will be discussed further in section 6.2. Overall, the relatively small number of differences between IFRS and FRS, especially with further improvements in IFRS expected after completion of the improvements project and the ongoing work on the FASB convergence project seem to satisfy the criterion that IFRS is a viable high quality financial reporting framework for New Zealand which is at least strong as that presently existing in New Zealand¹⁸.

A further measure of quality accounting information that has been investigated by empirical researchers is the extent to which that information reflects information that influences share prices. This metric reflects the value relevance or informativeness of the information. In general this research has found that different accounting systems are equally informative to the market (Chan and Seow, 1996). Leuz (2002) is unable

¹⁶ We are indebted to the authors for providing their permission to reproduce this summary.

¹⁷ Any such adjustments will have a huge impact on some companies, for example, in their 2002 Annual Report Independent Newspapers Limited report \$1,376,841,000 worth of intangible assets which exceeds the total shareholders' equity of \$1,138,617. It is possible that a significant component of intangible assets may need to be written down to comply with IAS 38.

¹⁸ Appendix 4 provides a reproduction of a summary of the differences between IFRS and domestic GAAP for selected countries, from www.ifad.net

to differentiate between the informativeness of IFRS and US GAAP financial statements for a sample of German companies. Similarly, Ashbaugh and Olsson (2002) find that IFRS and US GAAP are equally value relevant for non-US UK listed firms. In contrast, Barth and Clinch (1996), Harris and Muller (1999) and Pownall and Schipper (1999) find that the Form 20-F reconciliations from IFRS to US GAAP are value relevant, which could suggest that US GAAP was more value relevant than IFRS. However, Barth and Clinch (1996) and Pownall and Schipper (1999) point out that the Form 20-F reconciliations are not representative of firms that use IFRS but do not choose to list in the US, so therefore, they are unable to conclude that US GAAP are more informative than IFRS. Aldford et al. (1993) find differences in informativeness between different GAAP however; they report that the differences were attributable to institutional factors. Ball et al (2000) also find that any differences between IFRS and US GAAP in terms of the alleviation of information asymmetry and market liquidity are explained by institutional factors. In other words, the differences in informativeness were attributable to differences in infrastructure and enforcement rather than the accounting systems per se.

There are two studies that are able to report a positive improvement in the value relevance of accounting information when firms switch from domestic GAAP to IFRS. Auer (1996) found a switch from Swiss GAAP to IFRS improved value relevance. Barth, Clinch and Shibano (1999) identified increased price informativeness and trade volume, but only where harmonised to more precise GAAP and only in some circumstances. These empirical findings offer only weak support for the assertion that the informativeness of accounting information can be improved by a switch to IFRS if changing from a lower quality framework.

We conclude that there is evidence that IFRS have and will continue to improve in quality through the IASB's current improvements project and its technical agenda for new IFRS's. The recent policy of convergence with the financial reporting standards issued in the United States by the Financial Accounting Standards Board (FASB) inspires further confidence in continuing improvement. Further, the IFRS standards take a "principle-based" approach with standards developed based on an underlying conceptual framework which is consistent with the recommendations of many commentators in a post "Enron affair" environment¹⁹. There is also empirical evidence, which supports the conclusion that financial reports prepared using IFRS are at least as informative as those prepared using US Generally Accepted Accounting Practice (GAAP) and other domestic GAAP.

5.2 Quality of the IASB Standard Setting Process

Miller (1996) contends that a 'due process' that is open, neutral and independent will ensure that all constituents have adequate opportunity to participate in the accounting standard-setting process. The IASB is broadly representative with 14 members from nine different countries and is financed by the major accounting firms, private financial institutions and industrial companies throughout the world, central and development banks, and other international and professional organisations. The Trustees of the International Accounting Standards Committee Foundation appoint

¹⁹ ICANZ (2002) support the continuation of a "principle-based" financial reporting framework for New Zealand.

the board members. The trustees also monitor the IASB's effectiveness, raise funds for the IASB, approve the IASB's budget and have responsibility for setting out its constitution. The IASB is further supported by the Standards Advisory Council (SAC) which provides the means for other groups and individuals to advise the IASB and its Trustees. The SAC is broadly representative, having approximately fifty members with diverse backgrounds from different countries. Another prominent body in the IASB's structure is the International Financial Reporting Interpretations Committee (IFRIC). The committee has twelve members and IOSCO and the EU have non-voting observers. Its role is to interpret the application of IFRS's and to provide timely guidance on financial reporting issues not specifically addressed in IFRS's.

Both the IASB and IFRIC have a set 'due process' that is designed so that constituents have opportunity to participate in the process. IFRS are developed using a 'due process' that ensures input from accountants, financial analysts and other users of financial statements, the business community, stock exchanges, regulatory and legal authorities, academics and other interested individuals and organisations. The Board consults in public meetings, consults with the SAC on major projects, agenda decisions and work priorities, and discusses technical matters in meetings that are open to public observation (McGregor and van Zijl, 2002)²⁰. Notable aspects of the 'due process' are the issue of a discussion paper for public comment, publishing an exposure draft for comment, consideration of all comments received and may include a public hearing if necessary²¹. For a standard to be approved, there must be at least eight supporting votes and all dissenting opinions will be published. Similarly, the IFRC is required to consult widely, publish draft interpretations and consider all public comments.

While the IASB has a clearly articulated 'due process' they also have a very wide and diversified constituency. So while we accept that the processes of the IASB are consistent with best practice as it exists for the major accounting standard-setting bodies across the world, we do so with the caveat that smaller, less powerful constituencies, such as New Zealand, need to ensure that they maintain a high level of input into the process. This point is discussed further in section 6.4.

5.3 International Acceptance of IFRS

A further gauge of the quality of IFRS is the extent of international acceptance of these standards by countries for companies listed on their stock exchanges. The extent of adoption of IFRS varies across the world although there is a clearly identifiable trend towards increasing adoption. Appendix 2 provides a summary of the world's stock exchanges requirements for domestic and foreign companies as at the end of 2001.

A number of countries require or allow the use of IFRS for both their domestic and foreign registrants. In most instances, the countries making a comprehensive adoption of IFRS have been those with developing economies and/or low quality domestic standard-setting arrangements. It should be noted that some commentators have

²⁰ The IASB also publishes the agenda of its meetings on its website and publishes a Basis for Conclusions when each standard is issued.

²¹ The complete 'due process' of the IASB can be found at www.iasb.org.uk

expressed concerns that low quality reporting and infrastructure countries will adopt IFRS in an attempt to camouflage their institutional weaknesses. Ball et al. (2000) point out the adoption of IFRS by low quality reporting countries will only improve the quality of financial reporting if their enforcement mechanisms and other political, legal and economic institutions are also improved. Spence (1973) and Francis et al. (2002) are concerned that the adoption of IFRS by poor reporting jurisdictions will impact negatively on the IFRS brand name. Ball et al. (2000) counter this position by arguing that markets are efficient enough to see through purely cosmetic changes in standards so will not be fooled.

A majority of countries permit foreign registrants to report using IFRS, although some require a reconciliation to domestic GAAP, most notably Canada and the United States. While concessions for foreign registrants falls short of endorsement of IFRS it does indicate that these jurisdictions believe that the information provided is of sufficient quality for investors to be reliably informed.

By far the most significant endorsement of IFRS has come from the European Union and Australia, which will adopt IFRS in their entirety by January 2005. The recent moves by the EU and Australia are the first instances where developed economies have committed to the adoption of IFRS.

The EC International Accounting Standards Regulation 1606/2002 states that all EU companies that are listed on a regulated market should, from 1st January 2005, comply with IFRS^{22 23}. In the case of the EU, the quality of domestic accounting frameworks vary from very high quality in the United Kingdom to low quality in members countries such as Germany²⁴ so the benefits of adopting IFRS are clearly identifiable.

A single set of accounting reporting standards is regarded as essential to ensure a high degree of transparency and comparability of financial statements and hence the efficient functioning of the EU capital market and the Internal Market. This proposal therefore constitutes a priority measure (European Parliament Daily Notebook, 12/3/2002).

The Internal Market Commissioner, Frits Bolstein adds his support:

I believe that IAS are the best standards that exist. Applying them throughout the EU will put an end to the current Tower of Babel in financial reporting. It will protect us against malpractice. It will mean investors and other stakeholders will be able to compare like with like. It will help Europeans to compete on an equal footing when raising capital on world markets (Bolstein, 2002).

²² This requirement is an EU Regulation which has the force of law without requiring transposition into national legislation.

²³ Ian Wright of PriceWaterhouseCoopers contends that the trigger for the EU adoption of IFRS came in 2000 with discussions about an Action Plan for Financial Services and Financial Markets (subsequently called the Financial Services Plan) confirming the strategy for a single European capital market (www.pwcglobal.com).

²⁴ La Porta et al. (1998) rate the accounting standards of the United Kingdom as having the best accounting standards in their sample of 49 countries whereas they rank Germany 39th.

This position is explored further in the Department of Trade and Industry (DTI) consultation document which raises the question as to whether the UK should extend this requirement beyond listed companies.

Extending the requirements should make accounts more comparable and so potentially assist companies that do business or seek capital across borders; not to do so could act as an artificial barrier to growth for certain companies. On the other hand, compliance with the regulations will increase costs for some companies in conversion costs to the new system and so any extension of the application would extend the burden beyond the larger companies who are arguably best placed to cope with it (DTI 2002),

The decision to adopt IFRS in Australia was made by the Financial Reporting Council (FRC)²⁵.

The FRC fully supports the Government's view that a single set of high quality accounting standards which are accepted in major capital markets will greatly facilitate cross-border comparisons by investors, reduce the cost of capital, and assist Australian companies wishing to raise capital or list overseas (FRC, 3 July 2002).

The AASB has revised its convergence policy in light of the FRC's decision. It has decided that in future it will issue exposure drafts and standards at the same time as they are issued by the IASB. However, the AASB has announced some key modifications to the wholesale adoption of IFRS;

- it retains its commitment to sector-neutral standards and will add extra material if necessary for not-for-profit or public sectors
- it will continue to develop domestic standards in areas not dealt with by the IASB (AASB, August 2002).

Further, CLERP 9 states that Australia retains the right to not fully endorse IASB standards on the 'rare occasion' that they are not appropriate for domestic conditions.

In other major jurisdictions, where IFRS are not yet adopted, namely Canada and the United States, there are policies of convergence between their domestic GAAP and IFRS²⁶. The Accounting Standards Board (AcSB) of the Canadian Institute of Chartered Accountants (CICA) has adopted two internationalisation policies:

- harmonisation with US GAAP (that is elimination of significant unjustifiable differences) and
- convergence with FASB, IASB and other national standard-setting bodies.

Detailed consideration of the Canadian position regarding international convergence/harmonisation was given in the Canadian Securities Administrators Discussion Paper, Financial Reporting in Canada's Capital markets (CSA, 2001) and in Richardson and Hutchinson (1999). The first paper made the case that significant costs savings would be made if Canada removed its requirement for foreign registrants to reconcile to Canadian GAAP (not yet adopted) while the second paper

²⁵ The FRC was established under the Australian Securities and Investments Commission Act 2001 with a key function being to advise government on the standard-setting process and the development of international accounting standards and to approve and monitor the AASB's priorities.

²⁶ GAAP 2001 reports that approximately twenty countries have adopted an active agenda of convergence.

presented the case that Canada would be best served by converging with IASB GAAP, rather than US GAAP, although they do note that the differences between IASB GAAP and US GAAP are being gradually dissipated.

The position of the United States is paramount to any consideration of the future of international convergence/harmonisation, with most individuals seeing any holdout by the Americans as being a serious treat to internationalisation (Ravlic, 2001). Paul Volker, Chairman of the IASC Trustees, appealed to the United States Congress in his Statement before the Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee (June, 2001), for the United States to commit to the development of a global set of accounting standards.

I believe there are strong reasons for the United States to participate actively in this work. The exercise of strong leadership and responsible stewardship with respect to the integrity of our capital markets has long been in the national interest. As the world's strongest economy, and as a leading proponent of open international markets, those considerations extend globally. We should practice what we preach (p.6).

Concerns about the reticence of the United States have recently been abated by the FASB's strong commitment to convergence between FASB and IASB GAAP. In September, 2002, the FASB and the IASB issued a joint Memorandum of Understanding which sets out an agreement between the two bodies to use their best efforts to propose changes to US and international accounting standards to resolve some and perhaps all differences between them. They further committed to eliminate or reduce any remaining differences through continued progress on joint projects and co-ordination of future work programmes. The FASB's commitment to this agreement is evidenced by the comments of its Chairman, Mr Robert Hertz, "The FASB is committed to working toward the goal of producing high-quality reporting standards worldwide to support healthy global capital markets. By working on the short-term convergence project-as well as on longer-term issues - the chances of success are greatly improved" (FASB 29/10/2002).

There is also empirical evidence of a trend for multinational companies from many jurisdictions to adopt IFRS (most voluntarily). Appendix 3 sets out a list of companies using IFRS as of 28th August 2002. KPMG (2000) surveyed executives from a sample of European companies which had adopted IFRS to ascertain their motives. The most common explanations provided for their switch to IFRS were: the possibility of increasing the availability of capital and reducing its costs; the high quality of the standards and the preferences of institutional investors and analysts. While most of these companies are from developing economies or low quality reporting countries, this evidence does support the conclusion that IFRS are perceived to be of sufficiently high quality to be attractive to them.

In summary, IFRS standards are of high quality, are supported by a high quality standard-setting process and have an increasing level of international acceptance by stock exchanges and multinational companies. Our conclusion therefore is that the IASB reporting framework would be an acceptable standard-setting regime for New Zealand.

6 A Cost/Benefit Analysis of Adopting IFRS in New Zealand

The conclusion that the IASB reporting framework would be an acceptable alternative is a necessary but not sufficient to support a switch of regimes. Any decision to switch to IFRS must be driven by a cost/benefit analysis. Our analysis addresses the following aspects:

1. Direct compliance costs
2. Access to capital and economic growth
3. Standard-setting costs
4. Enforcement issues
5. Other issues.

6.2 Direct Compliance Costs

One component of compliance costs related to a switch to IFRS are the costs that will be initially incurred by preparers, users, auditors and regulators in re-training themselves on the requirements of the new reporting framework and planning and preparing for the transition²⁷. We have identified a number of instances of differences between existing Financial Reporting Standards (FRS) and IFRS which would require re-training. However, it is our opinion that the extent of these differences are relatively minor and will be diminished even further given the IASB's improvement project and the policy of convergence with FASB's. Further, it should be noted that the proposed policy of international harmonisation/convergence set out by the Financial Reporting Standards Board (FRSB) in ED 92 would in the long-run result in the minimisation or even complete removal of these differences. In which case, New Zealand firms will ultimately be required to make the changes whether a regime shift is adopted or not. It must also be noted that ICANZ already considers that IFRS form part of New Zealand GAAP in instances where FRS's are silent (see section 3).

A second, and important, source of concern regarding compliance costs are the economic consequences for New Zealand firms of having to change their existing set of accounting policies and the related set of accounting decisions to fit the new framework. In their seminal book "Positive Accounting Theory", Watts and Zimmerman (1986) use a costly contracting framework to explain how accounting numbers are used as the measures to adjudicate contracts such as debt contracts and management remuneration contracts. There is a large body of empirical evidence that supports the contention that managers choose a portfolio of accounting policies that maximise the contractual position of themselves and/or their firm (Watts and Zimmerman, 1990). Therefore, costs may be significant where a firm is forced to change an accounting policy that suits its existing portfolio of accounting policy choices which could ultimately impact on the investment decisions made by those firms. These costs will vary across firms and are difficult to estimate.

As pointed out in section 5.1, the most significant impact on some New Zealand companies from the adoption of IFRS will be that IAS 38 "Intangible Assets" may

²⁷ While the EU's decision has generally been greeted with applause, there are calls to proceed with caution. A 2002 survey by PriceWaterhouseCoopers found that chief financial officers of 650 EU companies expressed concerns at the major training effort that will be necessary to reach the 2005 deadline.

require them to derecognise and/or reverse previous revaluations of intangibles such as brandnames or mastheads. This could have a negative effect on contractual arrangements such as debt covenants if these assets are included in assets denominator of leverage constraints. However, as already pointed out, the FRSB has issued ED 87 “Accounting for Intangible Assets”, which has accounting requirements identical to IAS 38. Although corporate New Zealand would be expected to point out that ED 87 was issued in 1999 and has not yet been issued as an FRS, possibly due to the sectors lobbying against ED 87. The immediate adoption of IAS 38 arguably short-circuits this due process.

The deciding point on this issue must lie in the FRSB’s commitment to convergence/harmonisation set out in ED 92 which ultimately would result in most if not all of these changes in the long-run. Therefore the compliance costs for New Zealand companies associated with these changes have just been moved forward.

6.3 Access to Capital and Economic Growth

The increasing globalisation of the world’s economy adds an extra dimension to Black’s (2001) essential characteristics of a strong securities market, that is, one that articulates well with strong securities markets internationally. Currently New Zealand companies wishing to access capital from different jurisdictions must comply with the different listing and reporting requirements of each market, which imposes costs and inefficiencies with international capital flows. At the present time a small number of New Zealand companies are listed on foreign exchanges chiefly the Australian Stock Exchange (ASX). As at December 2001 there were only six New Zealand companies registered and reporting with the US Securities and Exchange Commission²⁸. While these numbers are small, it could be argued that the removal of an international barrier, through the adoption of IFRS, might make overseas listing more viable for New Zealand companies.

New Zealand has been relatively successful at attracting foreign registrants to the NZSE with 50 of the total 195 listed companies as at December 2001 being foreign companies²⁹. A move to IFRS for both domestic and foreign companies would simplify the reporting requirements of the NZSE. At present foreign companies are permitted to use the GAAP of their parent company’s country, IFRS, US GAAP or UK GAAP. The imposition of IFRS may be a slight deterrent if companies are not already using IFRS. However, this will not be an issue for Australian companies, as they will already be required to use IFRS in their own jurisdiction.

There is a body of empirical research that supports the conclusion that strong securities markets have improved access to capital and in the long-term have greater economic growth. There is also limited evidence, which links the quality of financial reporting to the strengthening of securities markets and hence logically to improved access to capital and greater economic growth (see section 2). The theoretical basis for expecting an improvement in access to capital and ultimately economic growth is that improved information and/or greater confidence in the quality of that information will decrease uncertainty and ultimately investors’ assessment of risk (Choi, 1973).

²⁸ See www.sec.gov

²⁹The World Federation of Exchanges Statistics 2001.

Botosan (1997) provides evidence of a link between improvements in the transparency of financial disclosures and decreases in the cost of capital. The Securities Exchange Commission (SEC) has long accepted the effect of disclosure on the costs of capital as explained by Levitt (1998).

Limited research has addressed the issue of whether the adoption of the IASB GAAP has created perceptible changes in either the access to capital for domestic firms and/or the economic growth of the economy. Leuz and Verrechia (2001) found that for German firms in the Neumarket that changed from national to IFRS standards there was an identifiable fall in their cost of capital. However, it should be noted that they proxied the cost of capital using the bid-ask spread, trading volume and stock return volatility³⁰. Barth et al. (1999) contend that the cost of capital could be either positively or negatively affected depending on the direction of change in the error of accounting measurement. Despite having established positive consequences of the adoption of IASB standards for developing or low quality reporting countries, these studies cannot be generalised to a regime such as New Zealand which already has a developed economy and high quality financial reporting framework. There is therefore no support for an argument that the adoption of IFRS in New Zealand will lead to improved access to capital or greater economic growth.

Paramount for the New Zealand Securities Commission in any consideration of the value or otherwise of adopting IFRS must be the potential impact on investor confidence. New Zealand already scores well in international comparisons between financial reporting frameworks and their supportive infrastructure (La Porta et al. (1998) but we must remain cognisant that from an international perspective New Zealand is a very small player in the global economy³¹. We must accept that any deviation from an internationally accepted perspective could threaten our international credibility. The Australians have already acknowledged the precarious position of relatively smaller markets. "Australian financial standards have always been regarded as highest quality. The problem we suffer is (that) no one else understands them. If you want to play an international game, you have to use a language that everyone understands" (Financial Reporting Council (FRC) Chairman Jeff Lucy, AFR 8 July 2002). It is arguable that in the longer run if New Zealand sets out alone with a unique financial reporting framework which departs from the international norm and in the shorter term from Australia will be regarded with suspicion and our capital market will be perceived as higher risk. This would result in a higher cost of capital for New Zealand firms and ultimately could lead to decreases in economic growth.

6.4 Standard-Setting Costs

A real challenge to NZ, should the decision be made to adopt IFRS, is to maintain a high level of input into the IASB due process to ensure that any specific circumstances for NZ are given adequate consideration. The sheer size of the ultimate constituency of the IASB and the relative small size of the New Zealand component of that constituency would mean that it would be imperative that New Zealand

³⁰ A link between shrinking bid-ask spreads, enhancing trading volume and diminishing stock return volatility and drops in the costs of capital was evidenced by Admati and Pfleiderer (1988).

³¹ The World Federation of Exchanges Statistics 2001, report that New Zealand's market capitalisation of domestic firms at the end of 2001 was US\$17 736.5m as compared to the global market capitalisation of US\$26 610 565.8m i.e. less than .07%.

maintain a deliberate strategy of maintaining our influence including the maintenance of a strong and highly relevant domestic standard-setting body.

A switch to IFRS may reduce the costs for New Zealand of operating a stand alone accounting standard-setting body. However, it would remain important that New Zealand maintains an independent standard-setting body:

- to participate in the due process of the IASB standard-setting process,
- to provide input on issues that may be unique to New Zealand, which will involve lobbying and consultation with the New Zealand constituency
- to participate in the IASB's deliberations by working on individual project
- to evaluate new IFRS for their suitability for application in New Zealand with a view to any necessary 'fine tuning'³² or in extreme cases withholding endorsement of an IFRS³³
- to modify/add to IFRS to suit the public sector to maintain New Zealand's commitment to sector neutral financial reporting standards³⁴.

These responsibilities would be onerous and it is arguable that any reduction in standard-setting costs would be minimal³⁵. However, if cost reduction is a high priority then the possibility of merging with the Australian AASB should be considered. Nonetheless, any New Zealand body should continue to work closely with their Australian counterpart.

Richardson and Huchinson (1999) state that if Canada were to adopt IFRS (or US GAAP) they would need a domestic standard setter which is broadly representative and which puts less emphasis on technical issues and greater emphasis on lobbying to promote their national interests. We suggest that the same need would exist in New Zealand. A further consideration is that the independence of such a body would need to be protected by having its funding provided by different sources.

6.5 Audit and Enforcement Issues

Many commentators contend that the adoption of one set of international financial reporting standards is doomed to failure unless there is a single international body to enforce the application of these standards internationally. However, in a developed country such as New Zealand which already has high quality reporting standards and arguably high quality financial reporting infrastructure the absence of an international regulatory body should not represent an impediment to the adoption of IFRS. This position has some support. "The ideal would be to establish a regulatory system that applies to everyone using IAS worldwide" "But this is an unrealistic goal at present so we need to find ways of national regulators working together so that they

³² It should be noted that commentators have warned the efficacy of the IFRS framework will be threatened if individual jurisdictions excessively 'fine tune' the standards (refs).

³³ The EU and Australia have reserved this right (FEE, 2002; CLERP 9, 2002).

³⁴ IFAC has established the International Public Sector Accounting Standards Board which has the mandate of developing and setting financial reporting standards for the public sector. However, these standards are still in their infancy so it is our opinion that New Zealand should continue its commitment to dual public/private sector standards by modifying IFRS's to accommodate public sector specific reporting requirements (similar to the AASB in Australia).

³⁵ It could be argued that the role of the FRSB will not change significantly since they have had a harmonisation policy with Australia since 1997.

collectively enforce a consistent application of IAS and retain confidence in the enforcement system that protects investors and analysts” (FEE, PWC Oct 2002). The challenge becomes finding a means of aligning the national audit and enforcement activity at national levels.

Moves have commenced on an international auditing framework. IFAC has established the International Auditing and Assurance Standards Board (IAASB). The IAASB has issued a number of International Statements on Auditing (ISA). IOSCO is desirous of the enhancement of these ISA's into a workable package as soon as possible to facilitate the global recognition of IFRS³⁶. While this international auditing framework is not yet operable, New Zealand already has a well established and workable domestic framework.

6.6 Other Issues

New Zealand has been a world leader in the reform of public sector financial reporting. A cornerstone of these developments has been our commitment to sector neutral financial reporting standards. This represents a potential impediment to the adoption of IFRS as they focus on the private sector in isolation. Australia intends to address this problem by issuing standards that contain the relevant IFRS and where necessary augment this with further public sector specific content. An obvious problem with such an approach is that standards could become complicated and internally inconsistent. We suggest that New Zealand follows the Australian proposal, however, in recognition of the potential problems, maintains a strong and independent financial reporting standard-setting body.

A further issue that has been discussed is whether IFRS should be adopted for just listed companies, or for all reporting entities. For a small market such as New Zealand, the practical difficulties that could arise from having more than one set of standards for different classes of reporting entity mean that a proposal to apply IFRS only to listed entities is not desirable. The NZSE has expressed its opposition to any change that would affect listed companies only (23rd Oct 2002 The Dominion Post). It is arguable that a simple listed versus unlisted company differentiation is unjustified without any solid conceptual justification. That would merely create an artificial hurdle for listing. A more workable proposal for change is one that would promote the comparability of financial reports of entities for global investors and markets, whilst also maintaining comparability of financial reports for domestic users and investors.

It should be a priority for New Zealand to pursue a financial reporting framework that ensures high quality, transparent and comparable financial reports. However, this consideration needs to be balanced with the policy of not imposing unnecessary compliance costs on entities. An issue to consider is whether it is justified to exempt some entities from preparing financial reports using IFRS in the interest of minimising compliance costs: for entities that are small in size with little economic impact; for those that are closely-held, and for those that do not have public accountability or the coercive power to tax/levy/rate. Such entities may be permitted to use some other comprehensive basis of accounting (eg. tax-based accounting) or some other suitable basis for financial reporting.

³⁶ See www.iosco.org

The question becomes on what basis would “the line should be drawn” as to which entities should be required to use IFRSs to prepare financial reports, and which may report otherwise. The alternatives are a set of black letter tests, which provide an objective test, or to adopt a more “principle-based” conceptual approach that is more consistent with the current approach of the FRSB and the IASB. The latter approach is the one currently adopted in Australia through its adoption of their “reporting entity” concept. The Australian Statement of Accounting Concepts SAC1 “Definition of the Reporting Entity” limits the applicability of financial reporting standards to “reporting entities”. The definition of a “reporting entity” is one where “it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources” (para.40). Under the Australian Corporations Law small, non-public companies (gross annual operating revenue of less than AUS \$10 million; gross assets of less than AUS \$5 million; and less than 50 employees at year end) are only required to prepare annual financial statements if required by 5% of the shareholder votes.

A further issue which must be considered is the implications of the New Zealand Australia Closer Economic Relations Trade Agreement 1983 (CER) and the AASB’s and ASRB’s obligation to work toward the harmonisation of financial reporting standards between Australia and New Zealand (Financial Reporting Act 1993). Should New Zealand not follow the recommendation of the ASRB to adopt IFRS then our performance under these agreements would be jeopardised if not entirely breached.

A further political consideration which should not be ignored is the potential effect on the credibility of New Zealand standard-setters and the financial reporting infrastructure of this decision. Richardson and Hutchinson (1999) make a strong case for Canada’s adoption of IFRS, “Canada has the opportunity to take a leadership role in the development of global financial reporting standards and should avoid short-term decisions, which will increase the time and the net costs of achieving global harmonization” (Richardson and Hutchinson , 1999. p. 22).

We also point out that while considering the appropriateness of adopting IFRS in New Zealand it would be opportune for the Commission to consider a related issue that we suggest should be reformed. Section 33 of the Securities Act 1978 requires Issuers to prepare Prospectuses that contain financial information disclosures that comply with the requirements of the Securities Regulations 1983. The Securities Regulations prescribe the financial disclosures required, which are sometimes the subject of exemptions permitted by the Securities Commission under Securities Act Exemption Notices, to accommodate particular situations faced by an issuer. A review of the Exemptions issued by the Securities Commission between 1997 and 2000, reveals that between 300 and 500 of these have been enacted in legislation annually. Exemptions granted in respect of the financial information disclosures of the Securities Regulations sometimes permit alternative disclosures which are at variance with financial reporting under GAAP. We suggest that the number of exemption notices could be avoided, or substantially reduced in content, if the Securities Regulations 1983 were replaced with the requirement for compliance with GAAP, as defined in the FRA, for Prospectuses. Such a move by the Securities Commission would bring

substantial cost savings to players in the financial markets from having one set of financial reporting standards acceptable to the Securities Regulator for capital raising purposes and the Registrar of Companies for the purpose of filing periodic financial reports, both based on GAAP.

7 Conclusion and Recommendations

Our review of the performance of the existing financial reporting framework in New Zealand fails to identify any obvious deficiencies in terms of international best practice, so one might ask the question, if it is not broken, why fix it? The answer lies in the fact that New Zealand should not be complacent and must continue to be forward looking to ensure that we are able to maintain our high standing in the long-term. Further, we must accept that New Zealand is a very small player in the global capital market and cannot afford to ignore the rapid pace of change in the international arena. We have evidenced the growing credibility of the IASB as the source for international financial reporting standards and the continuing momentum towards the adoption of IFRS across the world. New Zealand has the opportunity to build on its reputation as an important contributor to the development of high quality and internationally accepted financial reporting standards by being an ‘early mover’ in what is arguably an inevitable path towards one set of global financial reporting standards.

The analysis presented in this paper supports the conclusion that the IASB financial reporting regime is a viable alternative to New Zealand’s existing financial reporting regime. Further, our cost/benefit analysis suggests that there will be long-term net benefits for New Zealand from adopting IFRS. We therefore recommend that the Commission:

1. Supports the recommendation made by the ASRB for New Zealand to adopt IFRS.
2. Supports the policy of the ASRB to adopt IFRS in a manner which preserves their commitment to sector neutral financial reporting standards for New Zealand
3. Encourages an adoption date in line with that of Australia and the European Union or at least as close as is reasonably possible to that date.
4. Supports the maintenance of a strong, independent and representative standard-setting body in New Zealand with a number of difference funding sources
5. Considers the replacement of the financial information disclosure requirements of the Securities Regulations 1983 with the requirement for compliance with GAAP, as defined under the FRA for Prospectuses.

Further, while outside the scope of this paper we recommend that the Commission continue to foster developments in the other three aspects of the financial reporting infrastructure, that is, corporate governance, external audit and enforcement.

APPENDIX 1 The Differences Between New Zealand FRS and IFRS

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Set out below is a summary of the incompatibilities between the New Zealand and international pronouncements as at 31 October 2001.

Presentation of Financial Reports

- IAS 1 *Presentation of Financial Statements* and IPSAS 1 *Presentation of Financial Statements* provide for a fair presentation override with additional disclosures, while the New Zealand pronouncements require compliance with GAAP and provision of additional information to achieve fair presentation.
- The international standards require minority interest to be presented separately from liabilities and equity in the statement of financial position, while FRS-2 *Presentation of Financial Reports* requires such disclosure to be presented as part of equity.

Inventories

- IAS 2 *Inventories* allows for the use of the LIFO formula to determine cost of inventories.
- IPSAS 12 *Inventories* allows for the use of current replacement cost as alternative to net realisable value where inventories are held for distribution at zero or nominal charge or for consumption in the production process of goods that will be distributed at zero or nominal charge.

Extraordinary Items, Fundamental Errors, Changes in Accounting Estimates and Changes in Accounting Policies

- The IAS 8 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies* definition of extraordinary items does not require the event to be outside the control or influence of the entity whereas the FRS-7 *Extraordinary Items and Fundamental Errors* and IPSAS 3 *Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies* definitions include this requirement.

Construction Contracts

- IPSAS 11 *Construction Contracts* distinguishes between commercial and non-commercial contracts. Treatment for non-commercial contracts focuses on recognising contract expenses and allocating contract costs to the correct reporting period.

Income Taxes

- IAS 12 *Income Taxes* and SSAP-12 *Accounting for Income Tax* are based on fundamentally different concepts with regard to the type of accounting differences between tax methods and financial reporting methods (i.e. temporary differences and timing differences) that are required to be recognised.

Property, Plant and Equipment

- IAS 16 *Property, Plant and Equipment* requires revaluation changes to be accounted for on an individual asset basis, while FRS-3 *Accounting for Property, Plant and Equipment* requires revaluation changes to be accounted for on a class of assets basis.

- IAS 16 applies to property constructed or developed for future use until completed where these assets will be treated as investment property and accounted for under IAS 40 *Investment Property*.
- IAS 16 (and IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*) requires that a government grant related to an asset to be deducted in determining the carrying amount of the asset or accounted for as deferred income and allocated to income over the life of the asset. FRS-3 requires a subsidised asset to be recognised at fair value and the donation or subsidy to be recognised as revenue in the statement of financial performance.
- IAS 16 allows for the capitalisation of subsequent expenditure when future economic benefits are greater than the originally assessed standard of performance. As opposed to originally assessed standard of performance, FRS-3 considers recently assessed standard of performance.
- IAS 38 Intangible Assets requires the application of an impairment test to be applied to revalued assets. FRS-3 does not require this as revaluations are required to be carried out with sufficient regularity to ensure that the carrying amount is not materially different from fair value.

Foreign Currencies

- IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IPSAS 4 *The Effects of Changes in Foreign Exchange Rates* allow exchange differences arising on translation of financial statements of independent foreign operation on disposal of the independent foreign operation to be recycled through the statement of financial performance.
- SSAP-21 *Accounting for the Effects of Changes in Foreign Currency Exchange Rates* requires the use of the forward contracted rate to measure and report short term transactions, whereas IAS 21 and IPSAS 4 require the liability to be recognised initially at the spot rate and subsequently at the closing rate and the forward contract to be initially measured at cost and subsequently at fair value.

Business Combinations

- IAS 22 *Business Combinations* requires the pooling of interest method to be used in circumstances where the investor cannot be identified.
- IAS 22 has a rebuttable presumption that the useful life of goodwill will not exceed 20 years, while FRS-36 *Accounting for Acquisitions Resulting in Combinations of Entities or Operations* disallows amortisation over a period exceeding 20 years.
- FRS-36 requires the discount on acquisition to be accounted for by reducing proportionately the fair values of the identifiable non-monetary assets and the excess to be recognised in revenue immediately. IAS 22 requires:
 - the amount relating to future expected losses and expenses to be recognised as revenue when the losses and expenses are recognised; and
 - the amount not relating to future expected losses and expenses, limited to the fair values of acquired identifiable non-monetary assets, to be recognised as revenue over the remaining average useful life of such assets, and the excess to be recognised as revenue immediately.

Related Party Disclosures

- IAS 24 *Related Party Disclosures* does not require disclosure of transactions between government-controlled business entities and other government controlled entities, but SSAP-22 *Related Party Disclosures* includes all public sector entities.

Financial Reporting by Superannuation Schemes

- FRS-32 *Financial Reporting by Superannuation Schemes* requires all scheme assets to be measured at net market value, whereas IAS 26 *Accounting and Reporting by Retirement Benefit Plans* requires the scheme investments to be valued at fair value and operational assets valued according to the applicable IAS.
- IAS 26 allows for more flexible reporting as it does not require the traditional financial statements required in FRS-32, but requires a statement of net assets and a statement of changes in net assets.

Consolidated Financial Statements and Accounting for Investments in Subsidiaries

- IAS 27 *Consolidated Financial Statements and Accounting for Investments in Subsidiaries* and IPSAS 6 *Consolidated Financial Statements and Accounting for Controlled Entities* require presentation of minority interest as an item separate from equity and liabilities, whereas FRS-2 considers minority interest to be part of equity.

Accounting for Investments in Associates

- FRS-38 *Accounting for Investments in Associates* does not permit the application of the equity method where market value accounting is applied.

Disclosure by Financial Institutions

- FRS-33 *Disclosure of Information by Financial Institutions* has several exclusions to the definition of financial institution that are not excluded from the corresponding definition in IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*.
- FRS-33 requires current period changes relating to general provisions to be recognised in the statement of financial performance, while IAS 30 requires such changes to be recognised against retained earnings.
- In addition to revenues and expenses derived from assets and liabilities which have been set-off, IAS 30 also allows for the offsetting of revenue and expenses relating to hedges.

Joint Ventures

- IAS 31 *Financial Reporting for Interests in Joint Ventures* and IPSAS 8 *Financial Reporting for Interests in Joint Ventures* use the term jointly controlled entities to refer to partnerships and other forms of arrangements whereas SSAP-25 *Accounting for Interests in Joint Ventures and Partnerships* deals only with partnerships.

Provisions and Contingencies

- The treatment for contingent assets and liabilities under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* is asymmetrical, whereas FRS-15 *Provisions, Contingent Liabilities and Contingent Assets* requires symmetrical treatment for contingent assets and liabilities.
- Under IAS 37 reimbursement should be virtually certain before recognition, while FRS-15 allows for reimbursement to be recognised when probable.

- IAS 37 allows for offsetting of the reimbursement amount against the expense, while FRS-15 requires separate presentation.

Intangible Assets

- IAS 38 *Intangible Assets* requires cost to be reliably measured in order to be recognised. The *Statement of Concepts* permits recognition where the cost or other value can be reliably measured.
- SSAP-3 *Accounting for Depreciation* defines residual value as the estimated net realisable value at the end of an asset's useful life, whereas IAS 38 assumes residual value to be zero unless there is a third party commitment to purchase the asset or when there is an active market.

Investment Property

- IAS 40 *Investment Property* requires investment property to be measured at cost or fair value, whereas SSAP-17 *Accounting for Investment Properties and Properties Intended for Sale* requires measurement at net current value.
- IAS 40 allows for properties intended for sale to be treated as investment property, but SSAP-17 requires such properties to be reclassified and carried at the lower of carrying amount or net realisable value.
- IAS 40 requires valuation changes, if recognised, to be charged to income, while SSAP-17 requires recognition of valuation changes in income or as a revaluation reserve.
- Development property intended to be held is recognised in terms of IAS 16 *Property, Plant and Equipment* until completion, while under SSAP-17 the development margin on such properties will be recognised in accordance with FRS-14 *Accounting for Construction Contracts* if the SSAP-17 criteria are met, otherwise it will be accounted for at the lower of cost and net realisable value.

Defeasance of Debt

- FRS-26 *Accounting for Defeasance of Debt* allows for debts to be removed from the statement of financial position when repaid or refinanced, or through legal or in substance defeasance. IAS 39 *Financial Instruments: Recognition and Measurement* permits debt to be removed only through repayment or legal release.

APPENDIX 2 Stock Exchanges and IASB Standards

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Country	IFAC Member	Stock Exchange	Company	
			Domestic	Foreign
Argentina	Yes	The Buenos Aires Stock Exchange	Argentine GAAP	Argentine GAAP, IAS, or their national GAAP in which case they must provide a reconciliation to Argentine GAAP
Australia	Yes	The Australian Stock Exchange	Australian GAAP	May follow IAS
Austria	Yes	Wiener Börse	Either IAS or US GAAP financial statements must be used.	Either IAS or US GAAP financial statements must be used.
Bangladesh	Yes	Chittagong Stock Exchange	IAS	IAS
		Dhaka Stock Exchange	IAS	IAS
Belgium	Yes	Brussels Stock Exchange	May follow IAS if have significant foreign operations or foreign sources of capital	May follow IAS
Brazil	Yes	Rio de Janeiro Stock Exchange	Brazilian GAAP	Brazilian GAAP
		Sao Paulo Stock Exchange	Brazilian GAAP	Brazilian GAAP
Canada	Yes	Toronto Stock Exchange	Canadian GAAP	Canadian GAAP
		Alberta Stock Exchange	Canadian GAAP	Canadian GAAP
		Montreal Stock Exchange	Canadian GAAP	IAS or US, UK, or Australian GAAP with a reconciliation to Canadian GAAP
		Vancouver Stock Exchange	Canadian GAAP	National GAAP with a reconciliation to Canadian GAAP
Cayman Islands	No	Cayman Islands Stock Exchange	IAS or US, Canadian, or UK GAAP, or other equivalent standards acceptable to the Exchange	IAS or US, Canadian, or UK GAAP, or other equivalent standards acceptable to the Exchange
Chile	Yes	Santiago Stock Exchange	Chilean GAAP	National GAAP with a reconciliation to Chilean GAAP
China	Yes	Shanghai Stock Exchange	Companies that have issued B-Shares must follow IAS. Companies that have issued H-Shares may follow either IAS or Hong Kong accounting standards. Companies that have issued A-Shares must follow accounting standards promulgated by the People's Republic of China Ministry of Finance	
		Shenzen Stock Exchange		
Croatia	Yes	Zagreb Stock Exchange	IAS	IAS
Cyprus	Yes	Cyprus Stock Exchange	IAS	IAS
Czech Republic	Yes	Prague Stock Exchange	IAS	IAS
Denmark	Yes	Copenhagen Stock Exchange	May use IAS or US or UK GAAP with a reconciliation to Danish GAAP	May use their national GAAP with a reconciliation to Danish GAAP; or is their national law allows the use

				of IAS, US, or UK GAAP, the company may use that GAAP without a reconciliation to Danish GAAP
Egypt	Yes	Cairo Stock Exchange	IAS	IAS
Estonia	No	Tallinn Stock Exchange	IAS	IAS
Europe		EASDAQ Exchange	May follow IAS	May follow IAS
Finland	Yes	Helsinki Stock Exchange	May follow IAS if more than 50% of the shares are owned by foreigners or if the company is listed in an OECD country outside the European Economic Area, with reconciliation to Finnish GAAP	May follow IAS or US or UK GAAP or their national GAAP with reconciliation to Finnish GAAP
France	Yes	Paris Stock Exchange	May use IAS for consolidated financial statements	Allows for IAS. Companies based in the EU are allowed to follow national GAAP
Germany	Yes	Deutsche Börse	May follow IAS for consolidated financial statements	IAS
		Frankfurt Stock Exchange	May follow IAS for consolidated financial statements	IAS
		Bavarian Stock Exchange	May follow IAS for consolidated financial statements	IAS
		Stuttgart Stock Exchange	May follow IAS for consolidated financial statements	IAS
Hong Kong	Yes	Stock Exchange of Hong Kong	Hong Kong GAAP	May follow either Hong Kong GAAP or IAS. Exchange allows UK GAAP on a case-by-case basis. If the exchange is not the primary listing, the company may follow the accounting principles of the market of the primary listing
Hungary	Yes	Budapest Stock Exchange	Companies with cross-border activities must follow IAS. Other listed companies are allowed to follow IAS	IAS
Indonesia	Yes	Jakarta Stock Exchange	Must follow Statements and Interpretations of the Indonesia Committee on Financial Accounting Standards	Must follow Statements and Interpretations of the Indonesia Committee on Financial Accounting Standards
Iran	Yes	Tehran Stock Exchange	Iranian GAAP	Iranian GAAP
Israel	Yes	The Tel Aviv Stock Exchange	Israeli GAAP, which is based on US GAAP	Israeli GAAP
Italy	Yes	The Italian Exchange (Milan)	May follow IAS for consolidated financial statements	IAS
Jamaica	Yes	Jamaica Stock Exchange	Statements and recommendations of the	Statements and recommendations of the

			Institute of Chartered Accountants of Jamaica	Institute of Chartered Accountants of Jamaica
Japan	Yes	Tokyo Stock Exchange	Japanese GAAP	IAS if they use IAS financial statements for listing purposes in their home country or any other country
Jordan	Yes	The Amman Stock Exchange	IAS	IAS
Kazakhstan	Yes	Kazakhstan Stock Exchange	Kazakhstan GAAP	“A-listed” companies must use IAS. Other listed companies follow Kazakhstan GAAP
Korea	Yes	Korea Stock Exchange	Korean GAAP	IAS or national GAAP with reconciliation to Korean GAAP
Kyrgyz Republic	Yes	Kyrgyz Stock Exchange	Kyrgyz GAAP	Kyrgyz GAAP
Latvia	No	Riga Stock Exchange	All “Official List” companies must follow IAS. Otherwise they must use Latvian GAAP.	All “Official List” companies must follow IAS.
Lithuania	No	National Stock Exchange of Lithuania	Companies on the “Official Trading List” must follow IAS	Companies on the “Official Trading List” must follow IAS
Luxembourg	Yes	Luxembourg Stock Exchange	Luxembourg GAAP	Allows IAS financial statements for foreign companies, provided EU directives are complied with. Foreign listed companies may also follow US or UK GAAP. Foreign listed companies may also follow their national GAAP if they include a reconciliation of significant differences with IAS.
Macedonia	No	The Macedonia Stock Exchange	IAS	IAS
Malaysia	Yes	Kuala Lumpur Stock Exchange	Malaysian GAAP	Malaysian GAAP, or IAS pursuant to “Guidelines for the Public Offering of Securities of Foreign-Based Companies With Listing and Quotation on the Kuala Lumpur Stock Exchange”.
Malta	Yes	Malta Stock Exchange	IAS	IAS
Mexico	Yes	Mexican Stock Exchange	Mexican GAAP	Mexican GAAP
Netherlands	Yes	Amsterdam Stock Exchange	Netherlands GAAP or IAS, US GAAP, or UK GAAP with a reconciliation to Netherlands GAAP	IAS or US GAAP without reconciliation to Netherlands GAAP
New Zealand	Yes	New Zealand Stock Exchange	NZ GAAP	Parent company’s national GAAP, IAS, US or UK GAAP
Norway	Yes	Oslo Stock Exchange	Norwegian GAAP	IAS, US, or UK GAAP without reconciliation to

				Norwegian GAAP
Pakistan	Yes	Karachi Stock Exchange	IAS	IAS
		Lahore Stock Exchange	IAS or UK GAAP	IAS or UK GAAP
Peru	Yes	Lima Stock Exchange	IAS	National GAAP with an explanation of differences with IAS
Poland	Yes	Warsaw Stock Exchange	Polish GAAP	IAS or US GAAP with a reconciliation to Polish GAAP
Romania	Yes	Bucharest Stock Exchange	Romanian GAAP	Romanian GAAP
Singapore	Yes	Stock Exchange of Singapore	Singaporean GAAP	IAS with no reconciliation to Singaporean GAAP, or US GAAP with reconciliation to Singaporean GAAP
Slovak Republic	No	Bratislava Stock Exchange	Slovak GAAP	IAS
Slovenia	Yes	Ljubljana Stock Exchange	IAS or US, UK or Slovenian GAAP	IAS or US, UK or national GAAP with no reconciliation to Slovenian GAAP
South Africa	Yes	Johannesburg Stock Exchange	South African GAAP or IAS	South African GAAP or IAS
Spain	Yes	Madrid Stock Exchange	Spanish GAAP	EU domiciled company may use national GAAP without reconciliation to Spanish GAAP. Other companies can use IAS, US GAAP or their national GAAP with an audited reconciliation to Spanish GAAP
		Barcelona Stock Exchange	Spanish GAAP	
		Bilbao Stock Exchange	Spanish GAAP	
		Valencia Stock Exchange	Spanish GAAP	
Sri Lanka	Yes	Colombo Stock Exchange	Sri Lanka GAAP, which is derived from IAS	Sri Lanka GAAP
Sweden	Yes	Stockholm Stock Exchange	Swedish GAAP	IAS
Switzerland	Yes	Swiss Stock Exchange	May follow IAS	IAS, or their national GAAP but may have to add supplementary disclosure to meet the requirements of Swiss GAAP
Taiwan	Yes	Taiwan Stock Exchange	Taiwanese GAAP	National GAAP with reconciliation to Taiwanese GAAP
Tanzania	Yes	Dar-es Salaam Stock Exchange	May follow IAS	IAS
Thailand	Yes	The Stock Exchange of Thailand	Thai GAAP	IAS, Thai GAAP or US GAAP
Turkey	Yes	Istanbul Stock Exchange	Turkish GAAP	IAS or US or UK GAAP
Ukraine	No	Ukraine Stock Exchange	Ukrainian GAAP	IAS or Ukrainian GAAP
United Kingdom	Yes	London Stock Exchange	UK GAAP	IAS or UK or US GAAP. May also follow national GAAP in which case a reconciliation to UK GAAP may be required

United States	Yes	New York Stock Exchange	US GAAP	US GAAP or IAS or national GAAP. If not
		NASDAQ	US GAAP	US GAAP, a note reconciling income statement and balance sheet items to US GAAP is required by regulation of the US Securities and Exchange Commission
		American Stock Exchange	US GAAP	
		Arizona Stock Exchange	US GAAP	
		Boston Stock Exchange	US GAAP	
		Chicago Stock Exchange	US GAAP	
		Chicago Board Options Exchange	US GAAP	
		Pacific Stock Exchange	US GAAP	
		Philadelphia Stock Exchange	US GAAP	
Uzbekistan	Yes	Tashkent Republic Stock Exchange	Uzbek GAAP	US GAAP
Zimbabwe	Yes	Zimbabwe Stock Exchange	IAS and Zimbabwean GAAP	IAS and Zimbabwean GAAP

**APPENDIX 3 Listed Companies
Using IFRS**

As of 28-08/2002

This summary is reproduced from the IASB website.

Austria

Austrian Airlines Group
BEKO Holding Aktiengesellschaft
Boehler Uddeholm
Creditanstalt
Erste Bank
EVN Energie vernunftignutzen
Sanochemia Pharmazeutika AG
Schoeller-Bleckmann Oilfield

Equipment

VA TECH
Verbund
Voest-Alpine Stahl
Wienerberger

Bahrain

Arab Banking Corp.
Batelco
Gulf International Bank
Investcorp Group
Taib Bank
Trust International Insurance

Company

Belgium

Coil
S.W.I.F.T.

Bermuda

Jardine Matheson

Botswana

Barclays Bank of Botswana Limited
Inco Holdings Limited
National Development Bank

Bulgaria

Bulbank

Canada

Homburg Invest Inc.

China

Shanghai Petrochemical
Sinopec Yizheng Chemical Fibre Co.

Croatia

Agrokor
Kreditna Banka Zagreb
Varazdinska Banka
Zagrebacka banka

Cyprus

Bank of Cyprus
Laiki Group

Czech Republic

CEZ (Czech Power Company)
Czech Telecom

Denmark

Aalborg Portland
Bavarian Nordic
Danisco
FLS Industries
Great Nordic
Incentive Group
Lundbeck
Navision
Neurosearch
SAS Group
SIS International

Estonia

Hansapank

Europe (Pan-European)

European Investment Bank
Eutelsat

Finland

Finnair
Nokia Group
Nordic Investment Bank
Partek
StoraEnso

France

Lectra Systems
Norbert Dentressangle

Germany

Aachener und Munchner

Beteiligungs

AC-Service AG
Adidas-Salomon
Allianz AG Holding
Alsen AG
Altana
Articon
Arxes information Design AG
Bayer
BHF-Bank
Bintech
Brain International AG
BWK (Bremfer Woll-Kammerei

AG)

CE Computer Equipment
Cenit AG
CineMedia Film AG

	Commerzbank	Hongkong Land Holdings Limited
AG)	DEAG (Deutsche Entertainment	Jardine Matheson
	Deutsche Bank	Mandarin Oriental
	DG Bank	Vtech Holdings Ltd
	DIS Deutscher Industrie Service AG	Hungary
	Dresdner Bank	Borsodchem
	Drillisch Telecom	MATAV Hungarian
	Dyckerhoff	Telecommunications Co. Ltd.
	ERGO Insurance Group	Mol
AG	Gerling Versicherungs-Beteiligungs	International
	Heidelberger Zement	African Development Bank
	Henkel	World Bank
	Hochtief	
	HSBC Trinkaus & Burkhardt KGaA	Italy
	Hypovereinsbank	ERG SA
	Infomatec Integrated Information	
Systems AG		Japan
	Infor Business Solutions	Nihon Dempa Kogyo Co., Ltd.
	Kinowelt	
	KWR	Kuwait
	Kraftwerk Laufenbrug	National Bank of Kuwait SAK
	Lintec Computer AG	
	LPKF Laser & Electronics	Latvia
	MAN Aktiengesellschaft	Latvijas Unibanka
	Medion AG	
	Mensch und Maschine	Malta
	Metro AG	Air Malta
	Mobilcom	Bank of Valletta
Group)	Munchener Ruck (Munich Re	HSBC Bank Malta Plc
	MVV Energie AG	Maltacom
	MWG-Biotech AG	Netherlands
	Odeon Film AG	EADS: European Aeronautic
	Preussag	Defence & Space Company
	Puma	Gucci
	RWE	Libertel
	Sachsenring	Teleplan
	Saltus	
	Sanacorp Pharmahandel AG	New Zealand
	Schering	Brierley Investments Limited
	Schmalbach-Lubeca	
	Senator Film	Norway
	SKW Trosterberg AG	First Olsen Tankers
	SoftM	SAS Group
	Sudzucker AG	
	SZ Testsysteme	Peru
	Tarkett Sommer	Credicorp
	Technotrans	
	Transtec	Russia
	Tria AG	Gazprom
	Vivanco	Red October (Moscow
	Wella	Confectionary Factory)
		Rostelecom
Greece		
	EFG Eurobank Ergasius	Slovakia
		Eurotel Bratislava AG
Hong Kong		
	Dairy Farm	Slovenia

	Banka Celje	Sulzer Brothers
	Banka Koper	Swisscom
	Banka Slovenije	Synthes-Stratec
	Nova Kreditna Banka Maribor	Tecan
South Africa		UBS AG
	Anglogold	Unaxis
	Barloworld Limited	Unilabs
	Rangold Resources	Von Roll
Spain		WMH Walter Meier Holding
	Amadeus	Xstrata
		Zellweger Luwa
		Zschokke
		Zurich Financial Services
Sweden		
	SAS Group	Turkey
	Telia AG	Arcelik
		Garanti Bank
Switzerland		
	Agie Charmilles	UAE
	Algroup	Al Dhafra Insurance Co.
	ASCOM	Emirates Bank Group
	Axantis	National Bank of Fujairah
	BB Biotech	National Bank of Umm Al-Qaiwain
	BB Medtech	
	BT&T	Zimbabwe
	Bucher Industries	BICC CAFCA
	Calida	Central Africa Building Society
	Clariant	
	Elektrizitats-Gesellschaft	
Laufenburg AG (EGL)		
	EMS-Chemie Holding AG	
	ESEC Group	
	Eichhof Holding AG	
	Forbo	
	Georg Fischer	
	Holderbank	
	Intershop	
	Jelmoli, Grands Magasins	
	Julius Bar	
	Kuehne & Nagal International AG	
	Kuoni	
	Lonzagroup	
	Motor Columbus	
	Movenpick	
	Nestle	
	New Venturetec	
	Novartis	
	Phoenix Mecano	
	Phonak	
	Rieter Holding Ltd	
	Roche	
	Sairgroup	
	Saurer	
	Schindler	
	Serono	
	SEZ Group	
	Siegfried	
	Sihl	
	Sika Finance	
	Societe Generale De Surveillance	

APPENDIX 4 Comparison between domestic GAAP and IFRS for a sample of countries

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Australia

Australian accounting may differ from that required by IAS because of the absence of specific Australian rules on recognition and measurement in the following areas:

Area	IAS
Intangible assets	IAS 38
The derecognition of assets	IAS 39.35
Provisions, except for certain specific cases such as redundancy and cyclical maintenance	IAS37
Defined benefit employee obligations	IAS 19
The treatment of dividends proposed after the balance sheet date, particularly as practice is generally to accrue them	IAS 10
Detailed requirements for calculating impairment; it is not necessary to discount the cash flows when calculating recoverable amount for impairment losses	IAS 36.5

There are no specific rules requiring disclosures of:

Area	IAS
The fair values of investment properties	IAS 40.69
Discontinuing operations	IAS 35
Segment liabilities	IAS 14.56

Inconsistencies between Australian and IAS rules that could lead to differences for many enterprises in certain areas. Under Australian rules:

Area	IAS
Trading, available-for-sale and derivative financial assets are not recognised at fair value	IAS 39.69
Trading and derivative liabilities are not recognised at fair value	IAS 39.93
Gains and losses on the change in value of trading financial instruments are not required to be taken to income	IAS 39.103
Hedge accounting is permitted more widely	IAS 39.142
Deferred tax is accounted for on the basis of timing differences rather than temporary differences	IAS 12.15
On disposal of a foreign entity, the cumulative amount of deferred exchange differences in equity is not recognised in income	IAS 21.37
Investment properties can be held at cost without depreciation	IAS 40.50
The changes in value of investment properties held at current value are taken to reserves	IAS 40.28
Revaluations of intangible assets are permitted without an active market	IAS 38.64
Poolings/unitings of interests are prohibited	IAS 22.77
In the context of a business combination accounted for as an acquisition, provisions may be created more extensively than under the IAS	IAS 22.31
A primary/secondary basis is not used for segment reporting	IAS 14.26
Earnings per share is calculated before extraordinary items, and there are other differences	IAS 33

In certain enterprises, these other issues could lead to differences from IAS:

Area	IAS
There are no specific rules concerning the translation of the financial statements of hyperinflationary subsidiaries	IAS 21.36
An event after the balance sheet date indicating that the enterprise is not a going concern is not treated as an adjusting event	IAS 10.13
Research costs could be capitalised if they meet a recoverability test	IAS 38.42

Negative goodwill is eliminated by proportionately writing down the carrying value of non-monetary assets	IAS 22.59
Government grants are recognised in full when an enterprise has a right to receive them and no obligation to repay	IAS 20.12/24
There is no specific prohibition of discounting of deferred tax balances	IAS 12.53

Canada

Canadian accounting may differ from that required by IAS because of the absence of specific Canadian rules on recognition and measurement in the following areas:

Area	IAS
A primary statement of changes in equity	IAS 1.7
The fair values of investment properties	IAS 40.69
Segment reporting of liabilities	IAS 14.56
The amount of net cash flows attributed to the operating, investing and financial activities of discontinued activities	IAS 35.27

Inconsistencies between Canadian and IAS rules that could lead to differences for many enterprises in certain areas. Under Canadian rules:

Area	IAS
In the context of a business combination accounted for as an acquisition, provisions may be created more extensively than under the IAS	IAS 22.31
Impairment reviews of goodwill and other intangibles with depreciable lives in excess of 20 years are not automatically required	IAS 22.56; IAS 38.99
Goodwill acquired prior to July 2001 is amortised for any fiscal year beginning before 1 January 2002 based on its useful life, limited to 40 years, and is not amortised for years beginning after 31 December 2001; goodwill acquired on or after 1 July 2001 is not amortised	IAS 22.40/42
For business combinations on or after 1 July 2001, negative goodwill should be allocated to specified non-financial assets, with the remainder treated as an extraordinary gain	IAS 22.59
Trading, available-for-sale and derivative financial assets are not required to be recognised at fair value	IAS 39.69
Trading and derivative liabilities are not required to be recognised at fair value	IAS 39.93
Financial assets are derecognised on a different basis	IAS 39.35
Hedge accounting is allowed under different criteria	IAS 39.142
Pre-operating costs are sometimes capitalised	IAS 38.56
Gains and losses on non-current foreign currency monetary balances are deferred and amortised over their minimum ascertainable lives	IAS 21.15
The financial statements of hyperinflationary subsidiaries are translated using the temporal method rather than adjusting the subsidiary's financial statements for foreign price levels	IAS 21.36
Impairment losses on assets other than intangible assets with indefinite lives and goodwill are calculated by reference to undiscounted cash flows rather than to the higher of discounted cash flows and net selling price; and it is possible that impairment calculations would not be made if there were persuasive evidence that conditions leading to impairment would not persist	IAS 36.5/58
Inventories can be valued at replacement cost, if lower than cost	IAS 2.6
Many liabilities and provisions are not discounted	IAS 37.45
Past service costs relating to employee benefits that are already vested are not generally recognised immediately	IAS 19.96
The accumulated benefit method for defined pension plans is used when future salary levels and cost escalation do not affect the amount of the employee future benefits and the discount rate used to determine pension liabilities may reflect the rate at which the liability could be settled	IAS 19.64/78
Segment reporting is based on management's organisation of segments for operational and internal reporting purposes, with no segment reporting on a secondary basis	IAS 14.69-72

In certain enterprises, these other issues could lead to differences from IAS:

Area	IAS
Business combinations must be accounted for as acquisitions	IAS 22.77
Although it is unusual for LIFO to be used, when it is there is no requirement to disclose the FIFO or current cost of inventory	IAS 2.36
It is possible, although unusual, to create provisions when there is no legal or constructive obligation	IAS 37.14
It is possible to base segment reporting on accounting policies other than those used in the financial statements	IAS 14.44

China

Chinese accounting may differ from that required by IAS because of the absence of specific Chinese rules on recognition and measurement in the following areas:

Area	IAS
Uniting of interests	IAS 22.8
Provisions in the context of acquisitions	IAS 22.31
Employee benefit obligations	IAS 19
Discounting of liabilities	IAS 37.45
The treatment of an issuer's financial instruments	IAS 32.18/23
The derecognition of financial assets	IAS 39.69
Hedge accounting for derivatives	IAS 39.142
The treatment of the cumulative amount of deferred exchange difference on disposal of a foreign entity	IAS 21.37

There are no specific rules requiring disclosures of:

Area	IAS
A primary statement of changes in equity, except for joint stock limited enterprises	IAS 1.7
The fair values of financial instruments (except for listed investments)	IAS 32.77
The fair values of investment properties	IAS 40.69
Discontinuing operations	IAS 35
Diluted earnings per share	IAS 33.47
The current or FIFO const of inventory, when LIFO is used	IAS 2.36

Inconsistencies between Chinese and IAS rules that could lead to differences for many enterprises in certain areas. Under Chinese rules:

Area	IAS
Certain subsidiaries with dissimilar activities can be excluded from consolidation	IAS 27.14
Subsidiaries are excluded from consolidation if intended for sale, even if previously consolidated	IAS 27.13
For most business combinations accounted for using purchase accounting, the identifiable assets and liabilities of subsidiaries acquired are consolidated based on their book values	IAS 22.40
Either provisions for major overhaul costs or deferral of incurred major overhaul costs are allowed	SIC 23
Trading and derivative financial assets and liabilities are generally not held at fair value	IAS 39.69/93
Proposed dividends are accrued	IAS 10.11
Deferred tax accounting is uncommon and, when done, is calculated on the basis of timing differences, with the deferral method or the liability method allowed	IAS 12
The definition of extraordinary items is wider	IAS 8.6/12
Certain disclosures relating to primary segments (e.g. acquisitions and depreciation of assets) are not required	IAS 14.57/58
There are no rules addressing the consolidation of special purpose entities	SIC 12

In certain enterprises, these other issues could lead to differences from IAS:

Area	IAS
Under some circumstances, finance leases can be recognised at the undiscounted	IAS 17.12

amount of minimum lease payments	
There is no specific requirement for segment reporting to be prepared on the basis of the policies used for financial reporting	IAS 14.44

France

French accounting may differ from that required by IAS because of the absence of specific French rules on recognition and measurement in the following areas:

Area	IAS
Impairment of assets	IAS 36
Impairment tests for goodwill and intangibles with depreciable lives in excess of twenty years	IAS 22.56; IAS 38.99
Accounting for employee benefit obligations since it is not mandatory to recognise a liability for post-employment benefits	IAS 19
The discounting of provisions	IAS 37.45
The calculation of basic and diluted earning per share	IAS 33

There are no specific rules requiring disclosures of:

Area	IAS
A primary statement of changes in equity	IAS 1.7
Transactions with related parties except for limited requirements	IAS 24.1/3
Discounting operations	IAS 35
Segment liabilities	IAS 14.56
The FIFO or current cost of inventory when LIFO is used	IAS 2.36
The fair values of investment properties	IAS 40.69

Inconsistencies between French and IAS rules that could lead to differences for many enterprises in certain areas. Under French rules:

Area	IAS
There is a requirement to hold at least one share of a special purpose entity to consolidate a controlled special purpose entity	SIC 12
No deferred taxes are accounted for a temporary differences arising from the difference between the carrying amount of investments in associates and their tax base, unless distributions are probable	IAS 12.39
Some business combinations can be treated as unitings of interest even if an acquirer can be identified, when at least 90% of the share capital is acquired by issuance of shares	IAS 22.8
Some intangible items can be recognised as intangible assets (market shares, portfolio of customers) even if they do not meet the definition of an intangible asset under IAS; these and some other intangible assets are not required to be amortised	IAS 38.7/17/93
Provisions recognised in the context of business combinations accounted for as acquisition of a subsidiary that is related to acquired research and development can be recognised as an expense immediately	IAS 22.27/40; IAS 38.79
An issuer's financial instruments are not classified on the basis whether they are in substance liabilities and compound instruments are not split on this basis	IAS 32.18/23
Provisions recognised in the context of business combinations accounted for as acquisitions may be more extensive	IAS 22.31
Own (treasury) shares held for stock-option plans or for trading purposes are shown as assets	SIC 16
Financial assets and liabilities are not fair valued except in very limited circumstances	IAS 39.69/93
Derivatives that are assets or liabilities are usually not shown in the balance sheet except for premiums paid and received; only unrealised losses on derivatives are accounted for in the income statement in the absence of hedge accounting	IAS 39.69/93
A financial assets should be derecognised when legal title is transferred even if the control is retained by the transferor	IAS 39.35/37/38
Hedge accounting is permitted more widely	IAS 39.142
Unsettled gains on foreign currency monetary items may be deferred	IAS 21.15

Formation expenses, set-up costs, training costs and advertising costs may be capitalised	IAS 38.56
Capitalisation of finance leases is a preferred treatment but is not required	IAS 17.12
The percentage of completion method is a preferred treatment but is not required for construction contracts	IAS 11.22
Provisions may be recognised in advance of what would occur under IAS, and more widely	IAS 37.14
Deferred tax balances are discounted if the timing of the reversal of the temporary differences can be estimated reliably	IAS 12.53
Extraordinary/exceptional items are defined more broadly	IAS 8.6/12

In certain enterprises, these other issues could lead to differences from IAS:

Area	IAS
There is a choice of methods for the translation of the financial statements of subsidiaries that use a currency of a hyperinflationary economy	IAS 21.36
When investment properties are accounted for at fair value, gains arising from fair valuation are credited to equity	IAS 40.28
The classification of a lease as a finance or an operating lease may be based on different criteria	IAS 17.3
The revaluation of assets does not have to be kept up to date	IAS 16.29
There is an option to present a cash flow statement reconciled to net indebtedness	IAS 7.45
When the cost of acquisition is less than the acquirer's interest in the fair values of the identifiable assets and liabilities acquired at the date of the acquisition, negative goodwill arising on the acquisition is first offset against fair value judgements made on the acquisition	IAS 22.59/63
Segment reporting can be avoided if the board of directors considers that it would be seriously prejudicial to the enterprise	IAS 14
No deferred taxes are recognised for temporary differences arising from the restatement of non-monetary assets of the financial statements of a foreign entity reporting in the currency of a hyperinflationary economy	IAS 12.15/24
No deferred tax should be recognised on taxable differences that arise from the fair valuation of intangible assets that are not amortised and cannot be sold separately from the acquired enterprise taken as a whole	IAS 12.15
When income tax loss carry forwards, or other deferred tax assets of an acquired enterprise, which were not recognised as an asset by the acquirer at the date of acquisition, are subsequently realised after the end of the period opened for adjustments to goodwill, the amount of goodwill is not reduced accordingly and the adjustment is recognised in the consolidated statement of income	IAS 22.85

Germany

German accounting may differ from that required by IAS because of the absence of specific German rules on recognition and measurement in the following areas:

Area	IAS
Currency translation of the financial statements of foreign subsidiaries	IAS 21
Annual impairment reviews when a depreciable life in excess of 20 years is used for goodwill or intangible assets	IAS 38.99; IAS 22.56
The treatment of certain financial instruments by their issuer as equity or liability	IAS 32.18
Consolidation of special purpose entities	SIC 12
There is no specific regulation on the recognition pattern of operating lease payments or on the recognition of lease incentives	IAS 17.25; SIC 15

There are no specific rules requiring disclosures of:

Area	IAS
A primary statement of changes in equity	IAS 1.7
FIFO or current cost of inventory when LIFO is used	IAS 2.36
Fair values of financial assets and liabilities	IAS 32.77
Fair values of investment properties	IAS 40.69
Related party transactions other than certain disclosures (e.g. payments to	IAS 24.22

management)	
Discontinuing operations	IAS 35
Earnings per share	IAS 33

Inconsistencies between German and IAS rules that could lead to differences for many enterprises in certain areas. Under German rules:

Area	IAS
The acquisition date of a subsidiary may be identified as the date of first time consolidation of the subsidiary which is often at the end of the year in which the acquisition took place	IAS 22.19/20
Certain business combinations may be accounted for as unitings of interest even though an acquirer can be identified	IAS 22.8
Provisions in the context of business combinations accounted for as acquisitions may be more extensive	IAS 22.31
On acquisition, the measurement of assets and liabilities acquired at their fair values must not exceed the cost of acquisition	IAS 22.59
Goodwill arising on consolidation can be deducted immediately against equity	IAS 22.40
Internally generated intangible assets which are expected to provide ongoing service to the enterprise must not be recognised	IAS 38.19
Foreign currency monetary balances are generally translated at the worse of transaction and closing rates so as to avoid the recognition of gains on unsettled balances	IAS 21.11
Trading, available-for-sale and derivative assets are not recognised at fair value	IAS 39.69
Trading and derivative liabilities are not recognised at fair value	IAS 39.93
Hedge accounting is permitted more widely	IAS 39.142
Impairment tests are based on single assets rather than cash generating units; and usually on market values replacement costs rather than discounted cash flows	IAS 36.5
Leases are normally classified according to tax rules, therefore leases are seldom recognised as finance leases	IAS 17.3
Inventories can be valued at the lowest of cost, net realisable value and replacement cost	IAS 2.6
Inventory costs may include attributable portions of general overheads	IAS 2.7
Provision are recognised more extensively than under IAS; and they are not generally discounted	IAS 37.14/45
Long term employee benefit calculations generally follow tax regulations with respect to the actuarial valuation method and discount rate, and they also generally do not take account of expected future salary increases	IAS 19.64/78/83
Actuarial gains and losses are generally recognised immediately rather than over average remaining service lives	IAS 19.92/93
Deferred tax is calculated on the basis of timing differences rather than temporary differences	IAS 12.5/15
Deferred tax assets arising on loss carry forwards must not be recognised, and most others need not be	IAS 12.24/34
Extraordinary items are defined more widely in practice	IAS 8.6/12

In certain enterprises, these other issues could lead to differences from IAS:

Area	IAS
In general the completed contract method is used for the recognition of revenues on construction contracts and services	IAS 11.12; IAS 18.4
Certain subsidiaries with dissimilar activities should be excluded from consolidation	IAS 27.14
There is also a choice to exclude certain other subsidiaries from consolidation	IAS 27.13
Finance lease income is usually recognised on a net cash investment basis rather than on a net investment basis	IAS 17.30
Own (treasury) shares are shown as assets, if held for re-issue, but otherwise they are deducted from equity	SIC 16
Start-up costs may be capitalised and amortised over four years	IAS 38.57
Costs of an equity transaction should be expensed as incurred	SIC 17
Negative goodwill arising on consolidation is treated differently	IAS 22.41/62

Hong Kong

Hong Kong accounting may differ from that required by IAS because of the absence of specific Hong Kong rules on recognition and measurement in the following areas:

Area	IAS
Employee benefits	IAS 19
Accounting for derivatives	IAS 39.69/93
The measurement of financial liabilities	IAS 39.93
Hedge accounting for derivatives	IAS 39.142

There are no specific rules requiring disclosures of:

Area	IAS
Fair values of financial assets and liabilities	IAS 32.77
Related party relationships where there are no transactions, except that the name of the ultimate holding company must be disclosed	IAS 24.20

Inconsistencies between Hong Kong and IAS rules that could lead to differences for many enterprises in certain areas. Under Hong Kong rules:

Area	IAS
Deferred tax is calculated on the basis of timing differences rather than temporary differences, and balances are only recognised if they are expected to crystallise	IAS 12.15
The recognition of deferred tax assets is more restrictive	IAS 12.34
Interests in leasehold properties in Hong Kong are not accounted for as leases as the lessee normally receives all the risk and rewards incident to ownership of the properties; these are accounted for as property, plant and equipment (carried at cost less accumulated depreciation or revalued amount) or investment properties (carried at revalued amount)	IAS 17.11
Gains and losses on the revaluation of investment properties are taken to reserves unless there is a deficit on a portfolio basis	IAS 40.28
Available-for-sale financial assets held for an identified long-term purpose may be valued at cost	IAS 39.69
An issuer's financial instrument is generally not classified based on the legal form rather than on the basis of whether or not it is in substance a liability, and compound instruments are not split on this basis	IAS 32.18/23
Disclosures relating to discontinuing operations may begin later than required under IAS	IAS 35.16
The format of the cash flow statement and certain disclosures and the definition of cash equivalents are different	IAS 7

In certain enterprises, these other issues could lead to differences from IAS:

Area	IAS
For Hong Kong incorporated parents, enterprises that are controlled by them but do not meet the definition of subsidiary under the Hong Kong Companies Ordinance are excluded from consolidation	IAS 27.6
There are no specific rules concerning the translation of the financial statements of hyperinflationary subsidiaries	IAS 21.36
The profit and loss account of the foreign enterprise may be translated either at the closing rate or at an average rate for the period	IAS 21.30
There are also no specific rules concerning own (treasury) shares	SIC 16

Japan

Japanese accounting may differ from that required by IAS because of the absence of specific Japanese rules on recognition and measurement in the following areas:

Area	IAS
The classification of business combinations as acquisitions or unitings of interest	IAS 22.8

The setting up of provisions in the context of business combinations accounted for as acquisitions	IAS 22.31
Impairment of assets	IAS 36
The discounting of provisions	IAS 37.45
The recognition of lease incentives	SIC 15
Accounting for employee benefits other than severance indemnities	IAS 19

There are no specific rules requiring disclosures of:

Area	IAS
A primary statement of changes in equity	IAS 1.7
The FIFO or current cost of inventories valued on the LIFO basis	IAS 2.36
The fair values of investment properties	IAS 40.69
Discontinuing operations	IAS 35
Segment reporting of liabilities	IAS 14.56

Inconsistencies between Japanese and IAS rules that could lead to differences for many enterprises in certain areas. Under Japanese rules:

Area	IAS
It is acceptable that overseas subsidiaries apply different accounting policies if they are appropriate under the requirements of the country of those subsidiaries	IAS 27.21
Under a temporary regulation, land can be revalued, but the revaluation does not need to be kept up to date	IAS 16.29
Pre-operating costs can be capitalised	IAS 38.57
Leases, except those which transfer ownership to the lessee, can be treated as operating leases	IAS 17.12/28
Inventories can generally be valued at cost rather than at the lower of cost and net realisable value	IAS 2.6
Inventory cost can include overheads in addition to those relating to production	IAS 2.6
The completed contract method can be used for the recognition of revenues on construction contracts	IAS 1.22
Some trading liabilities can be made on the basis of decisions by directors before an obligation arises	IAS 37.14
Proposed dividends can be accrued in consolidated financial statements	IAS 10.11
The discount rate for employee benefit obligation can be adjusted to take account of fluctuations within the previous five years	IAS 19.78
Any past service cost of employee benefits is spread of the average service lives of active employees even if the cost is vested	IAS 19.96
The portion of convertible debenture that is in substance equity is not normally accounted for as such	IAS 32.23
Extraordinary items are defined more widely	IAS 8.6/12
Segment reporting does not use the primary/secondary basis	IAS 14.26

In certain enterprises, these other issues could lead to differences from IAS:

Area	IAS
It is possible, though unusual, for dissimilar subsidiaries to be excluded from consolidation if the consolidation of such subsidiaries would mislead stakeholders	IAS 27.14
There are no requirements concerning the translation of the financial statements of hyperinflationary subsidiaries	IAS 21.36

New Zealand

New Zealand accounting may differ from that required by IAS because of the absence of specific New Zealand rules on recognition and measurement in the following areas:

Area	IAS
Intangible assets other than goodwill	IAS 38
The derecognition of financial assets	IAS 39.35
The prohibition of discounting of deferred tax assets and liabilities	IAS 12.53
Accounting for employee benefits, but defined contribution schemes are	IAS 19

predominant	
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There are no specific rules requiring disclosures of:

Area	IAS
Segment liabilities	IAS 14.56
Earnings per share	IAS 33

Inconsistencies between New Zealand and IAS rules that could lead to differences for many enterprises in certain areas. Under New Zealand rules:

Area	IAS
Impairments are recognised for permanent diminutions only	IAS 36.58
It is not necessary to discount the cash flows when calculating recoverable amount for impairment losses	IAS 36.5
In the context of a business combination accounted for as an acquisition, provisions may be created more extensively than under the IAS	IAS 22.31
Trading, available-for-sale and derivative financial assets are not required to be recognised at fair value	IAS 39.69
Trading and derivative liabilities are not required to be recognised at fair value	IAS 39.93
Hedge accounting is permitted more widely	IAS 39.142
Investment properties are held at net selling price rather than at cost or fair value	IAS 40.24
Gains and losses on the revaluation of investment properties can be taken to equity	IAS 40.28
Deferred tax is calculated on timing differences rather than on temporary differences, and a partial basis can be used	IAS 12.15
A primary/secondary classification is not used for segment reporting	IAS 14.26
On disposal of a foreign entity, the cumulative amount of deferred exchange differences in equity is not recognised in income	IAS 27.11

In certain enterprises, these other issues could lead to differences from IAS:

Area	IAS
Disclosures concerning a discontinuing operation might begin later	IAS 35.27
Certain controlled (in substance) subsidiaries need not be consolidated in limited circumstances if they do not meet the legal definition, however they must be equity accounted if not consolidated	IAS 27.11
Lessors are allowed to recognise finance lease income by reference to the net cash investment	IAS 17.30
There are not specific rules on the translation of the financial statements of hyperinflationary subsidiaries	IAS 21.36
Negative goodwill is eliminated by proportionately writing down the carrying value of non-monetary assets	IAS 22.59
It is possible that internally generated brands and similar assets could be capitalised	IAS 38.51

Singapore

Singapore accounting may differ from that required by IAS because of the absence of specific Singapore rules on recognition and measurement in the following areas:

Area	IAS
Hedge accounting, for derivatives	IAS 39.142
The derecognition of financial assets	IAS 39.35
The prohibition of discounting of deferred tax assets and liabilities	IAS 12.53

There are no specific rules requiring disclosures of:

Area	IAS
The fair values of investment properties carried at cost	IAS 40.69

Inconsistencies between Singapore and IAS rules that could lead to differences for many enterprises in certain areas. Under Singapore rules:

Area	IAS
Certain subsidiaries that are required to be excluded from consolidation under IAS cannot be excluded under Singapore rules	IAS 27.13
There is no requirement to recognise trading, available-for-sale and derivative financial assets at fair value	IAS 39.69
When financial assets revalued, gains can be taken directly to equity	IAS 39.103
There is no requirement to recognise trading and derivative financial liabilities at fair value	IAS 39.93
When investment properties are revalued, gains can be taken directly to equity	IAS 40.28
Foreign currency gains and losses on long-term monetary items can be deferred	IAS 21.15
The completed contract method can be used for the recognition of revenues on construction contracts	IAS 11.22
Income statements items of foreign subsidiaries can be translated at the closing rate	IAS 21.30
Deferred tax is calculated on the basis of timing differences rather than temporary differences, and partial provision (on the basis of likelihood of crystallisation of assets and liabilities) is allowed	IAS 12.5/15
Deferred tax assets on loss carry forwards are infrequently recognised	IAS 12.34

Taiwan

Taiwanese accounting may differ from that required by IAS because of the absence of specific Taiwanese rules on recognition and measurement in the following areas:

Area	IAS
Impairment of assets	IAS 36
The derecognition of financial assets	IAS 39.35
Recognition of operating lease payments and incentives	IAS 17.25; SIC 15
Hedge accounting for derivatives	IAS 39.142
Discounting of provisions	IAS 37.45
The prohibition of discounting of deferred tax assets and liabilities	IAS 12.53
The use of the projected unit credit method for calculating pension obligations	IAS 19.64
Disclosure of segment liabilities	IAS 14.56
Pooling of interests method	IAS 22.8

There are no specific rules requiring disclosures of:

Area	IAS
The fair values of investment properties	IAS 40.69
The FIFO or current cost of inventory when LIFO is used	IAS 2.36
Discontinuing operations	IAS 35

Inconsistencies between Taiwanese and IAS rules that could lead to differences for many enterprises in certain areas. Under Taiwanese rules:

Area	IAS
Special purpose entities are not generally consolidated	SIC 12
Provision in the context of business combinations can be made under less strict conditions	IAS 22.31
Trading, available-for-sale and derivative financial assets are not recognised at fair value	IAS 39.69
Trading and derivative liabilities are not recognised at fair value	IAS 39.93
Gains and losses on certain foreign currency receivables related to investments are deferred in equity	IAS 21.15
Pre-operating and start up costs can be capitalised	IAS 38.56
If investment properties are revalued, the gains are taken directly to equity	IAS 40.28
Split accounting is not permitted for compound instruments, and instruments are generally classified on the basis of their legal form	IAS 32.18/23
A primary/secondary classification is not used for segment reporting	IAS 14.26

Some employee benefits paid by cash and stock should be reported as a distribution of retained earnings	IAS 19.10
The discount rate for the calculation of employee benefit obligations takes account of long-term investment rates as well as current interest rates	IAS 19.78

In certain enterprises, these other issues could lead to differences from IAS:

Area	IAS
Some enterprises that are de facto controlled but not majority owned may be excluded from consolidation	IAS 27.6
Certain dissimilar subsidiaries can be excluded	IAS 27.13/14
Holdings of less than 20% in joint venture enterprises might be held on the cost basis	IAS 31.25/32
Financial statements of subsidiaries in hyperinflationary economies are remeasured using the reporting currency of the parent	IAS 21.36
The excess of the fair value of identifiable net assets acquired over the cost of an acquisition should be used to reduce the fair values of the non-monetary assets with only any remainder being recognised as negative goodwill	IAS 22.59
Inventories can be valued at replacement cost if this is below cost and net realisable value	IAS 2.6
Tangible and intangible assets may be revalued without revaluing a whole class of assets and without keeping the valuation up-to-date	IAS 16.29/34 IAS 38.64/70
Employee benefit past service costs must be amortised even if they are vested	IAS 19.96

United Kingdom

Inconsistencies between UK and IAS rules that could lead to differences for many enterprises in certain areas. Under UK rules:

Area	IAS
Employee benefit costs can be accounted for on a fundamentally different basis	IAS 19
There is more restriction on the setting up of provisions in the context of business combinations accounted for as acquisitions	IAS 22.31
Goodwill can be treated as having an indefinite life and therefore not amortised	IAS 22.44/51
Proposed dividends are accrued as liabilities	IAS 10.11
Deferred tax is calculated on the basis of timing differences rather than temporary differences, and balances can be recognised only if they are expected to crystallise, or when the event giving rise to the asset or liability has occurred by the balance sheet date	IAS 12.5/15
Deferred tax assets and liabilities can be discounted	IAS 12.53
The recognition of deferred tax assets can be more restrictive	IAS 12.34
Trading, available-for-sale and derivative financial assets are not recognised at fair value	IAS 39.69
Trading and derivative liabilities are not recognised at fair value	IAS 39.93
Hedge accounting is permitted more widely	IAS 39.142
An issuer's financial instruments which are legally shares are presented in equity irrespective of their substance, and compound instruments are not split into equity and liability components	IAS 32.18/23
Disclosures relating to discontinuing operations may begin later	IAS 35.16
Segment reporting does not use the primary/secondary basis; and it reports net assets rather than assets and liabilities separately	IAS 14.26/55/56
Cash flow statements reconcile to a narrowly defined "cash" rather than to "cash and cash equivalents"	IAS 7.45
On disposal of a foreign entity, the cumulative amount of deferred exchange differences in equity is not recognised in income	IAS 21.37

In certain enterprises, these other issues could lead to differences from IAS:

Area	IAS
Somewhat different criteria are used to determine whether a business combination is a uniting of interests	IAS 22.8

The financial statements of a hyperinflationary subsidiary can be remeasured using a stable currency as the measurement currency	IAS 21.36
Lessors recognise finance lease income on the basis of the net cash investment not the net investment	IAS 17.30
Segment reporting can be avoided if the directors consider that it would be seriously prejudicial	IAS 14.3
Own (treasury) shares are shown as assets; gains and losses are generally recognised as income	SIC 16
Revaluation gains and losses on investment properties are reported in the statement of changes in equity not in the income statement	IAS 40.28

United States

US accounting may differ from that required by IAS because of less specific rules in the US as follows:

Area	IAS
Discounting provisions is not clearly defined	IAS 37.45
The requirement for annual impairment tests when the depreciable lives of goodwill or intangible assets exceed twenty years	IAS 22.56; IAS 38.99

There are no specific rules requiring disclosures of:

Area	IAS
The fair values of investment properties	IAS 40.69
Segment reporting of liabilities	IAS 14.56

Inconsistencies between US and IAS rules that could lead to differences for many enterprises in certain areas. Under US rules:

Area	IAS
In the context of an acquisition, part of the purchase price should be allocated to research and development costs of an acquiree that can be identified and measured; these amounts are then expensed in the period after acquisition	IAS 22.27/40; IAS 38.79
Up to 30 June 2001, the classification of business combinations between acquisitions and unitings of interest is based on compliance with a set of criteria rather than whether an acquirer can be identified; subsequent combinations are treated as acquisitions	IAS 22.8
The derecognition of financial assets is based on legal isolation	IAS 39.35
Provisions in the context of business combinations can be made under less strict conditions	IAS 22.31
Provisions may be recognised on the basis of the probability of outflows of resources without there always being an obligation	IAS 37.14
Impairment tests use discounted cash flows and impairments are measured based on fair value rather than on recoverable amount	IAS 36.5/58
Once recognised, an impairment may not be reversed	IAS 36.95
An issuer's financial instruments are classified on the legal form of the instrument rather than on the basis of whether they are in substance liabilities, and compound instruments are not split on this basis	IAS 32.18/23
Segments are identified and information measured based on management's organisation of segments for operational and internal reporting purposes, with no segment reporting on a secondary basis, although certain geographic disclosure is required	IAS 14.69-72

In certain enterprises, these other issues could lead to differences from IAS:

Area	IAS
Some enterprises that are de facto controlled but neither majority owned nor contractually controlled may be excluded from consolidation	IAS 27.6; SIC 12
The excess of the fair value of identifiable net assets acquired over the cost of an acquisition should be used to reduce the fair values of the non-monetary assets with only any remainder being recognised as negative goodwill	IAS 22.59
Inventories can be valued at replacement cost, if lower than cost	IAS 2.6
Financial statements of subsidiaries in hyperinflationary economies are	IAS 21.36

remeasured using the reporting currency of the parent	
Employee benefit past service costs must be amortised even if they are vested and an additional minimum liability may have been recognised as a deduction of equity	IAS 19.96
Discontinuing operations disclosures may be made prior to a formal announcement	IAS 35.16
Defined benefit pension plans with flat-benefit formulas generally use a unit credit method to determine the liability and the discount rate used to determine pension liabilities reflects the rate at which the liability could be settled	IAS 19.64/78
Deferred taxes are calculated using enacted rates as opposed to those substantially enacted	IAS 12.34/47
Goodwill acquired up to 30 June 2001 is amortised for any fiscal year beginning up to 15 December 2001 based on the useful life, limited to 40 ears; goodwill acquired after 30 June 2001 is not amortised but is subject to an impairment test performed at least annually	IAS 22.44

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