

Invitation to Comment
on
FRSB and AASB Working Draft
Process for Modifying, or Introducing Additional
Requirements to, IFRSs for PBE/NFP

Intent of Document

The FRSB and AASB have been developing and documenting the process they will follow in considering whether to make modifications to International Financial Reporting Standards (IFRSs) to meet the needs of public benefit entities (PBE)/not-for-profit entities (NFP). Although the Working Draft is still under development, the FRSB and AASB are seeking comments at this time so that constituents can be involved as the Working Draft develops.

The FRSB and AASB expect the process, which will be publicly documented at all times, will evolve as new factors are encountered. The FRSB and AASB consider that the document explains the FRSB's and AASB's approach – it is not part of IFRSs as adopted in New Zealand and Australia and does not have the authority of a standard. It constitutes the process applied when considering, within existing policy, whether or not to modify an IFRS for PBE/NFP.

Issued by
Financial Reporting Standards Board
New Zealand Institute of Chartered Accountants
and the
Australian Accounting Standards Board

¹ The New Zealand Institute of Chartered Accountants is the operating name of the Institute of Chartered Accountants of New Zealand, a body established under the Institute of Chartered Accountants of New Zealand Act 1996. All references to the New Zealand Institute of Chartered Accountants, or to the Institute, in this document mean the Institute of Chartered Accountants of New Zealand.

Introduction

The FRSB continues to support the retention of one set of standards for all New Zealand entities and the AASB continues to support the retention of one set of standards for all Australian entities. To support this objective, the FRSB and AASB are developing and documenting a Process for determining whether to make modifications to International Financial Reporting Standards (IFRSs) to meet the needs of public benefit entities (PBE)/not-for-profit entities (NFP).

The Working Draft of the *Process for Modifying, or Introducing Additional Requirements to, IFRSs for PBE/NFP* is still being tested and remains the subject of discussion between the FRSB and the AASB. The timing of this FRSB and AASB Invitation to Comment aligns with the timing of the Request for Comment being released by the New Zealand Accounting Standards Review Board (ASRB) covering its revision to Release 8 *The Role of the Accounting Standards Review Board and the Nature of Approved Financial Reporting Standards*. The ASRB's Invitation to Comment can be found at www.asrb.co.nz.

Working Draft: *Process for Modifying, or Introducing Additional Requirements to, IFRSs for PBE/NFP*

The Working Draft specifies that potential modifications to IFRSs for PBE/NFP will be considered on a case-by-case basis. It requires two questions to be answered in the affirmative before a modification to IFRSs for PBE/NFP is considered and identifies factors that will be considered in developing answers to those questions, namely:

- (a) Are there PBE/NFP issues that might warrant modifying an IFRS for PBE/NFP?
- (b) Are the identified PBE/NFP issues so significant that a departure from IFRSs is warranted?

This Working Draft has been under development for some months and its content has been drawn from a number of sources including the *Process for Reviewing and Modifying IASB Documents* issued by the International Public Sector Accounting Standards Board (IPSASB) which outlines how the IPSASB reviews and modifies documents issued by the International Accounting Standards Board (IASB) for use in the public sector. The IPSASB Process has not been subject to formal exposure and is posted on the IPSASB website for information.

The FRSB and AASB are proposing a similar approach to that taken by the IPSASB after the consultation process. Once comments are received and considered, the revised Process will be placed on the websites of the New Zealand Institute of Chartered Accountants and the AASB. It will be updated from time to time, to take into account changes in the standard-setting environment such as the changing needs of users of financial statements issued by PBE/NFP, the FRSB's and AASB's experience in applying the Process and the impact of the present review of the New Zealand financial reporting framework and the AASB's differential reporting project. Comments on the Process will be considered at any time.

The FRSB anticipates that the ASRB will accept that the Process provides a sound basis for proposing modifications to IFRSs for PBE/NFP. It is important to note that the Process is not a standard or interpretation and will not form part of IFRSs as adopted in New Zealand and Australia. The Process will be placed on the Institute's and AASB's websites: it will not otherwise be published.

Invitation to Comment

The FRSB and AASB are seeking comments on any aspect of the Working Draft and will consider all submissions received. The FRSB and AASB request that constituents supplement their opinions by detailed comments, whether supportive or critical of the proposals, as both supportive and critical comments are essential to a balanced review. Comments are most helpful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Unless otherwise noted in a submission, all comments will be made available to both the FRSB and AASB.

Comments from New Zealand constituents should be addressed to:

Director – Accounting Standards
C/- New Zealand Institute of Chartered Accountants
PO Box 11 342
WELLINGTON
NEW ZEALAND
Email: ASD@nzica.com

Comment from Australian constituents should be addressed to:

Acting Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Victoria 8007
AUSTRALIA
Email: standard@asb.gov.au

Submissions must be received no later than 30 June 2009.

It would be appreciated if respondents to this 'Invitation to Comment' include a copy of their submission in electronic form (preferably Microsoft Word format) as that allows for the efficient collation and analysis of comments.

Respondents are requested to indicate, on their submission, on whose behalf the submission is being made (for example, own behalf, a group of people or an entity).



DRAFT

PROCESS FOR MODIFYING, OR INTRODUCING ADDITIONAL REQUIREMENTS TO, IFRSs FOR PBE/NFP

Introduction

1. Public benefit entities (PBE) are defined as “reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders” (NZ IAS 1 *Presentation of Financial Statements*, paragraph NZ 8.2).
2. A not-for-profit entity (NFP) is “an entity whose principal objective is not the generation of profit. A not-for-profit entity can be a single entity or a group of entities comprising the parent and each of the entities that it controls” (various AASB standards, including AASB 102 *Inventories*, paragraph Aus6.1).
3. **The purpose of modifying IFRSs for PBE/NFP is to reflect differences between the sectors, including differences in user information needs, that warrant a different accounting treatment or additional guidance for public benefit entities¹.** Both the FRSB and AASB are concerned that modifications to IFRSs for PBE/NFP be consistent between Australia and New Zealand to the extent possible. This draft *Process for Modifying, or Introducing Additional Requirements to, IFRSs for PBE/NFP* (Process) is designed to provide a consistent basis for considering whether to make modifications or amendments to IFRSs for application in New Zealand and Australia.
4. It should be noted that an objective of this draft Process is that different people applying it would generally come to similar conclusions about whether a PBE/NFP modification to an IFRS is warranted, although the FRSB and AASB acknowledge that this may not always be the case. Applying the draft Process will not necessarily result in a modification for PBE/NFP or that, where a modification is made, the FRSB and AASB will make an identical modification.
5. There is a range of views on the appropriate approach to modifying IFRSs for PBE/NFP. This Process is predicated on the following assumptions:
 - (a) IFRSs are developed by an expert standard setting board, the International Accounting Standards Board, and its views represent international consensus on best practice for for-profit entities.
 - (b) IFRSs are developed following a stringent due process which encourages parties interested in for-profit entities to express their views.
 - (c) Modifications to IFRSs may be required when the IASB’s focus on for-profit entities does not appropriately address PBE/NFP issues.
6. It follows from the above that the mere fact that either or both of the FRSB and AASB prefer a different requirement from that reached by the IASB on an issue will rarely be a sound basis for modifying an IFRS. There are many technical issues where individuals and Boards hold a range of views as to the appropriate treatment. Disagreement with the IASB’s treatment is unlikely to provide good reason, in and of itself, for changing the requirement in an IFRS.

Nature of modifications

7. In this Process, the term ‘modifications’ is used to encompass changes to IFRSs, the addition of requirements or guidance to IFRSs and the deletion of requirements or guidance from IFRSs as applied by PBE/NFP. As a general rule, the FRSB and AASB hold the view that the same principles should apply to all modifications: that is the same principles should apply when considering whether to change an IFRS

¹ This principle reflects the ASRB’s view expressed in paragraph 24 of ASRB Release 8 *The Role of the Accounting Standards Review Board and the Nature of Approved Financial Reporting Standards*.

requirement or add a requirement or guidance over and above that in an IFRS or develop a stand-alone standard.

8. In preparing and approving IFRSs for application in New Zealand and Australia, this Process has been developed to identify factors to assist in determining whether to make modifications i.e. whether to:
 - (a) amend, add or delete a presentation, disclosure, recognition or measurement requirement of an IFRS for application by PBE/NFP; or
 - (b) scope PBE/NFP out of a specific IFRS as adopted in New Zealand or Australia and deal separately with the relevant disclosure, presentation, recognition or measurement issues; or
 - (c) add a PBE/NFP disclosure or additional guidance to an IFRS; or
 - (d) create requirements applicable only to PBE/NFP, even though there is no corresponding IFRS.

Factors to be considered before modifying an IFRS

9. Two issues would generally be considered before modifying an IFRS for PBE/NFP:
 - (a) Are there PBE/NFP issues that might warrant modifying an IFRS for PBE/NFP?
 - (b) Are the identified PBE/NFP issues so significant that a departure from an IFRS is warranted?

(a) Are there PBE issues that might warrant modifying an IFRS for PBE/NFP?
10. As noted above, the basis for modifying IFRSs for PBE/NFP should generally be differences between the sectors, including user information needs. Information needs will generally differ between the sectors where treatments such as the selection of options and transactions, events and circumstances differ between the sectors in prevalence and/or differences in the balance between costs and benefits.
11. In some cases, increased or reduced prevalence of a treatment, transaction or event for PBE/NFP, as compared with for-profit entities, may require modifications to the relevant IFRS to ensure that user needs are met while considering the balance between costs and benefits. In other cases, a particular transaction or event may be significantly more common for PBE/NFP and the requirement in an IFRS may not meet user needs. In such cases, recognition and measurement requirements in an IFRS may be amended or a new standard may be developed to address the issue. The following factors would generally be reviewed when considering differences in user needs between the for-profit and PBE/NFP sectors:
 - (a) nature of transactions, events and circumstances and their impact on PBE/NFP;
 - (b) benefits of compliance to users; and
 - (c) costs of compliance.
12. These factors are considered on a case-by-case basis where the various factors will be weighed up in a specific case to determine whether a modification to an IFRS is warranted for PBE/NFP. In reaching a conclusion, individuals may give greater weight to some factors than to others. That is, in each case all the factors will be considered and then the particular relevance of the factors to the issue. Consideration of these factors does not, in and of itself, automatically result in the development of a modification to an IFRS for PBE/NFP.
13. The FRSB and AASB are aware that they may not have identified all the factors that should be considered in determining whether or not there is an issue that might lead to a modification of an IFRS for PBE/NFP. This Process will be updated where the FRSB and AASB encounter other factors in determining whether modifications to IFRSs for PBE/NFP are warranted.

Nature of transactions, events and circumstances and their impact on PBE/NFP

14. Few transactions, events and circumstances would uniquely occur in relation to PBE/NFP. However, some transactions, events and circumstances are more common among PBE/NFP than for-profit entities and may warrant a separate standard or more specific guidance. Transactions that would generally be considered on this basis include:

- (a) *Non-exchange transactions*, where an entity receives value from another entity without directly giving approximately equal value in exchange. Typical non-exchange transactions for PBE/NFP are the receipt of grants and donations and the exercising of taxing powers.
- (b) *Non-cash generating activities*, where the future economic benefits of an activity are not primarily dependent on the activity's ability to generate net cash inflows. Although such activities can occur in the for-profit sector, they are usually minor and subsidiary to the main objectives of the entity. In contrast, the majority of activities may be non-cash generating for some PBE/NFP.

Benefits of compliance to users

15. There are cases where user needs for information will differ between for-profit entities and PBE/NFP. In particular, users of the financial reports of PBE/NFP are likely to be especially interested in:
 - (a) service delivery, being the quality of the goods and services produced and whether this level of quality was appropriate;
 - (b) efficiency and productivity, being more likely to involve information that is based on costs and on information about outputs/outcomes that may be non-financial in nature; and
 - (c) sustainability, because the sustainability of a PBE/NFP is more likely to depend on it meeting its mission than on its profits and profitability, whereas the sustainability of a for-profit entity is primarily dependent on financial performance.
16. It follows that users of PBE/NFP financial reports may benefit from a modification that is not considered a significant benefit in respect of for-profit entities because of the relative frequency of certain transactions and other events. For example, in respect of an asset received for no cost, the determination of a deemed cost by reference to the asset's fair value at acquisition can be viewed as providing more relevant information (than would the IFRS cost-based treatment) for users in a PBE context in which non-exchange transactions are relatively more common. Such an amendment would result in a different measurement requirement for PBE/NFP from the measurement requirement applying to for-profit entities.
17. In evaluating the potential benefits for users arising from the application of a particular IFRS, the FRSB and AASB will generally consider any material in the IASB's Basis for Conclusions that identifies the benefits of the proposed treatment for for-profit entities. However, some of the bases for the IASB's conclusions may not be relevant to PBE/NFP or may be less relevant to PBE/NFP than for-profit entities.
18. Where the IASB's reasons for a requirement in an IFRS are regarded as applying equally in respect of PBE/NFP and for-profit entities, this factor would not apply.

Costs of compliance

19. A particular IFRS requirement may have a disproportionately costly impact on PBE/NFP, perhaps because of the frequency of particular types of transactions and other events among PBE/NFP. As an example of this factor, the relief from providing disclosures of the cost of an asset when the fair value model is applied in NZ IAS 16 *Property, Plant and Equipment* and AASB 116 *Property, Plant and Equipment* was based, in part, on the view that the costs of compliance with this disclosure given the frequent use of the fair value model by PBE/NFP, particularly in the public sector, were substantial with no corresponding benefit to users.
- (b) *Are the identified PBE/NFP issues so significant that a departure from IFRSs is warranted?***
20. Paragraphs 11-20 provide factors to identify differences between the for-profit sector and PBE/NFP. The second step is to determine whether these differences warrant a modification to IFRSs for PBE/NFP.
 21. The FRSB and AASB will take the following into account when deciding whether or not the identified PBE/NFP issue is so significant that a departure from IFRSs is warranted:
 - (a) an estimate of the significance of any modification on the financial statements;
 - (b) an estimate of the significance of a transaction, event or circumstance on the financial statements taken as a whole;

- (c) whether or not a modification will increase or decrease internal consistency within IFRSs as modified for PBE/NFP; and
- (d) the costs of preparing the modification and the costs of requiring preparers, auditors and users to learn two sets of requirements.

An estimate of the significance of any modification on the financial statements

22. A modification is unlikely to be warranted where the modification would have an insignificant effect on financial statements. That is, a modification will generally be made only if it gives rise to a significant resultant benefit in improved information from making the modification. There would be no reason to impose the costs of making the change on the parties involved in financial reporting if the anticipated benefit is marginal.

An estimate of the significance of a transaction, event or circumstance on the financial statements taken as a whole

23. A modification is likely to be warranted if the effect of a transaction, event or circumstance is such for PBE/NFP that the financial statements taken as a whole do not provide useful information or provide misleading information.

Whether or not a modification will increase or decrease internal consistency within IFRSs as modified for PBE/NFP

24. There is concern about the potential for modifications, or lack of modifications, to decrease internal consistency within IFRSs as modified for PBE/NFP. A modification will be looked on more favourably if it increases internal consistency within IFRSs as modified for PBE/NFP. Any approved modifications will amend all the standards affected by the issue.

The costs of the modification

25. Modifications are not necessarily costless: costs may be borne by preparers, auditors, users, regulators and standard setters in considering whether or not a modification to an IFRS should be made. If it is agreed that a modification should be made, then costs of developing and implementing that modification will also arise. Prior to the introduction of IFRSs, the view of the FRSB and the AASB was that like transactions should be treated in the same way. As there is limited capacity to amend IFRSs for for-profit entities and retain compliance with IFRSs, modifications to IFRSs for PBE/NFP will impose additional costs on participants in the financial reporting process where such modifications result in different reporting requirements for like transactions. All of these additional costs should not exceed the anticipated benefits.

Determining a different treatment for PBE/NFP

26. When it has been determined that a different recognition, measurement and/or disclosure requirement or different guidance is likely to be appropriate for PBE/NFP, the FRSB and AASB will determine what that different treatment should be. As with all standards, the FRSB and AASB would firstly have regard to their respective conceptual frameworks. The FRSB and AASB would also consider other authoritative guidance such as:
- any modification to IFRSs or a public sector specific standard issued by the International Public Sector Accounting Standards Board (IPSASB);
 - the IPSASB *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*²;
 - in the case of the FRSB, whether or not the AASB had modified, or was considering modifying, IFRSs in relation to the issue, and in the case of the AASB, whether or not the FRSB had modified, or was considering modifying, IFRSs in relation to the issue;

² The IPSASB Conceptual Framework is presently under development.

- a pronouncement issued by any other national standard setter using a similar conceptual framework; and
- the Government Finance Statistics Manual.