

New Zealand Society of Accountants

EXPLANATORY FOREWORD TO GENERAL PURPOSE FINANCIAL REPORTING

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1 INTRODUCTION

1.1 This explanatory foreword serves three purposes:

- (a) to explain the relationship between general purpose financial reports, the *Statement of Concepts for General Purpose Financial Reporting*, and financial reporting standards;

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- (b) to advise members of their responsibilities in relation to financial reporting standards and the *Statement of Concepts for General Purpose Financial Reporting*; and
- (c) to outline, in relation to generally accepted accounting practice, sources of authoritative support within the accounting profession in New Zealand.

The term *financial reports*, when used in this foreword, means general purpose financial reports.

1.2 This foreword states the responsibilities of members in either the public or the private sector, when preparing or presenting financial reports, or reporting on them.

1.3 This foreword is operative from the date of its approval by Council. An earlier version of the foreword was published in June 1993 for information purposes.

2 GENERAL PURPOSE FINANCIAL REPORTS

2.1 **General purpose financial reports** are financial reports which are intended to provide information to meet the needs of external users who are unable to require, or contract for, the preparation of special reports to meet their specific information needs.

2.2 General purpose financial reports provide information to users to enable them to:

- (a) assess the performance, financial position and cash flows of the entity;
- (b) assess the entity's compliance with legislation, regulations, common law and contractual arrangements, as they relate to the assessment of the entity's performance, financial position and cash flows; and
- (c) make decisions about providing resources to, or doing business with, the entity.

2.3 Financial reports consist of:

- (a) financial statements;
- (b) non-financial statements; and
- (c) supplementary information which is additional to the information in financial and non-financial statements.

2.4 The financial reporting standards apply to financial and non-financial statements, however titled, which have a function equivalent to those statements referred to in the standards. The financial and non-financial statements referred to in financial reporting standards are:

- (a) statement of financial performance;
- (b) statement of financial position;
- (c) statement of cash flows;
- (d) statement of movements in equity;
- (e) statement of service performance; and

- (f) such accounting policies and explanatory notes as a reader may need to understand the entity's financial and non-financial performance, financial position and cash flows.

3 RELATIONSHIP BETWEEN GENERAL PURPOSE FINANCIAL REPORTS, THE STATEMENT OF CONCEPTS FOR GENERAL PURPOSE FINANCIAL REPORTING AND FINANCIAL REPORTING STANDARDS

3.1 The *Statement of Concepts for General Purpose Financial Reporting* and financial reporting standards are developed in the public interest. Their use will both improve the quality of general purpose financial reporting and lead to greater uniformity in reports by minimising differences in accounting treatment.

Statement of Concepts for General Purpose Financial Reporting

3.2 The *Statement of Concepts for General Purpose Financial Reporting* defines the nature, subject, purpose and broad content of general purpose financial reports. It sets out concepts on which the preparation and presentation of such reports should be based.

3.3 The *Statement of Concepts for General Purpose Financial Reporting* will assist the Financial Reporting Standards Board in the development and review of financial reporting standards. The Society believes that the *Statement of Concepts for General Purpose Financial Reporting* will also assist:

- (a) users in interpreting financial reports;
- (b) preparers in applying financial reporting standards and in dealing with topics that have yet to form the subject of a financial reporting standard; and
- (c) auditors in forming an opinion as to whether financial reports provide a fair presentation.

Financial Reporting Standards

3.4 **Financial reporting standards** are rules which establish requirements for recognising, measuring and disclosing transactions and other events in general purpose financial reports. For the purpose of this explanatory foreword the term also encompasses the Society's Statements of Standard Accounting Practice.

3.5 In general, financial reporting standards are intended for application to all general purpose financial reports. Any limitation in the application of a financial reporting standard will be made clear in the text of that standard. In the application of a financial reporting standard the term entity refers to the economic entity reporting. Therefore, financial reporting standards apply in the preparation of financial reports by any entity, including a group entity or a legal entity.

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3.6 When preparing financial reports and making disclosures in them, the balance between benefits and cost should be maintained. The benefits derived from information should meet or exceed the costs of providing it. Evaluation of benefits and costs is subjective; the preparer and users of a financial report may have different perceptions of benefit and cost.

3.7 In order to recognise the benefit:cost balance when setting standards, the Society uses identifiable surrogates for benefits and costs. Based on those surrogates, certain requirements of financial reporting standards have been made optional for some entities. Such differential reporting concessions will be made clear in the text of each financial reporting standard. For a fuller explanation of the surrogates, reference should be made to the *Framework for Differential Reporting*.

The Relationship between the *Statement of Concepts for General Purpose Financial Reporting* and Financial Reporting Standards

3.8 The Financial Reporting Standards Board recognises that in a limited number of cases there may be a conflict between the *Statement of Concepts for General Purpose Financial Reporting* and particular financial reporting standards. Where a conflict exists, the requirements of the financial reporting standard should be followed. The Board will be guided by the *Statement of Concepts for General Purpose Financial Reporting* in the development of future financial reporting standards, and in the review of existing financial reporting standards. Therefore, the number of cases of conflict will decrease over time.

4 GENERALLY ACCEPTED ACCOUNTING PRACTICE

4.1 **Generally accepted accounting practice** is the term used to describe the basis on which financial reports are normally prepared. The term encompasses:

- (a) specific rules, practices and procedures relating to particular circumstances; and
- (b) broad concepts and principles of general application.

4.2 Financial reporting standards are the primary indicators of generally accepted accounting practice. Conformity with generally accepted accounting practice means:

- (a) compliance with all financial reporting standards applicable to the entity; and
- (b) in relation to matters for which no provision is made in financial reporting standards and that are not subject to any applicable rule of law, adopting accounting policies that:
 - (i) are appropriate to the circumstances of the entity; and
 - (ii) have authoritative support within the accounting profession in New Zealand.

4.3 Those entities reporting under legislation requiring compliance with financial reporting standards approved by the Accounting Standards Review Board will

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need to be aware of financial reporting standards so approved and the accounting periods for which they are approved. Such entities should note that the Society may not be the only organisation which has submitted financial reporting standards to the Accounting Standards Review Board for approval.

4.4 The Accounting Standards Review Board has, as one of its functions, the authority to give directions, for entities which fall within its jurisdiction, as to the accounting policies that have authoritative support within the accounting profession in New Zealand (Financial Reporting Act 1993 section 24(d)). The Accounting Standards Review Board has given such direction in Release 1: *Accounting Policies that have Authoritative Support within the Accounting Profession in New Zealand*, such that; “All [existing standards], other than FRS-29: *Prospective Financial Information*, which have been issued by the New Zealand Society of Accountants and are in force at 30 June 1994, but which have not been approved by the Accounting Standards Review Board, (are) deemed to have authoritative support within the accounting profession in New Zealand...”. The Accounting Standards Review Board has indicated that where the Society’s existing Standards do not provide coverage of accounting policies, the Accounting Standards Review Board’s direction should not be interpreted as excluding other possible sources of guidance on accounting policy choices in New Zealand.

4.5 Other sources of authoritative support for all entities in the preparation of general purpose financial reports are:

- New Zealand financial reporting standards which are applicable to analogous items or matters;
- guidance notes to New Zealand financial reporting standards;
- *Statement of Concepts for General Purpose Financial Reporting*;
- exposure drafts of financial reporting standards issued by the Financial Reporting Standards Board;
- interpretations by the Financial Reporting Standards Board of financial reporting standards;
- technical practice aids and technical guidance bulletins issued by the Financial Reporting Standards Board;
- research bulletins published by the Society;
- accounting standards published by the Australian Accounting Standards Board;
- international accounting standards published by the International Accounting Standards Committee;
- accounting standards published by other well-recognised bodies with the authority to promulgate financial reporting standards in other jurisdictions; and
- practice widely accepted as appropriate and prevalent for the industry or sector concerned.

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4.6 It is a matter for professional judgement in the circumstances of the entity as to which items above should be considered, and how conflicts between sources of authoritative support should be resolved, in determining generally accepted accounting practice. Professional judgement needs also to take account that the extent of authoritative support accorded particular sources may be affected by an absence of, or incomplete, due process.

4.7 The sources of guidance set out in paragraph 4.5 above would normally be more influential than other sources of authoritative support for determining generally accepted accounting practice. For entities subject to the jurisdiction of the Accounting Standards Review Board, directions given by that Board as to the accounting policies that have authoritative support rank ahead of other sources of authoritative support identified in paragraph 4.5 above.

4.8 Well-recognised bodies with the authority to promulgate reporting standards would be bodies such as those established in the United Kingdom, Canada and the United States of America.

5 FAIR PRESENTATION

5.1 The purpose of financial reports is to fairly reflect or to provide a true and fair view of an entity's performance, financial position and cash flows. In this foreword, the terms *fair presentation* and *fairly reflect* have the same meaning as *true and fair view*. In order for general purpose financial reports to show a true and fair view it is necessary to comply with generally accepted accounting practice.

5.2 In the rare circumstances that compliance with generally accepted accounting practice does not result in the financial reports giving a true and fair view, additional information and explanations are to be provided in order to give a true and fair view.

6 RESPONSIBILITIES OF MEMBERS TO OBSERVE GENERALLY ACCEPTED ACCOUNTING PRACTICE

Members Involved in, or Responsible for, the Preparation and Presentation of General Purpose Financial Reports

6.1 Members who are involved in, or have responsibility for, preparing or presenting financial reports should take all reasonable steps within their power to ensure that generally accepted accounting practice is complied with.

6.2 All material departures from generally accepted accounting practice should be disclosed and explained in the financial report. The explanation should include the reasons for the departure and its financial and non-financial effects.

Members Reporting on General Purpose Financial Reports

6.3 Members who are undertaking reporting engagements, such as audits or reviews, should encourage the preparers of financial reports to comply with generally accepted accounting practice.

6.4 All material departures from generally accepted accounting practice should be referred to in members' reports, whether or not the departures are disclosed in the notes to the financial report.

7 NON-COMPLIANCE WITH FINANCIAL REPORTING STANDARDS

7.1 The Society will enquire into apparent failures by members to comply with financial reporting standards and to disclose departures from them. If the Society is not satisfied with a member's explanation of the lack of compliance, it may take such action as it considers appropriate.

8 FUTURE DEVELOPMENTS AND WORKING PROCEDURE

8.1 Methods of reporting financial and non-financial information evolve and alter in response to changing needs. From time to time, new financial reporting standards will be developed, and established guidance will be reviewed, in order to improve financial and non-financial reporting practice in the light of new needs and developments.

8.2 The present working procedure is:

- (a) relevant subjects are selected for detailed study by the Financial Reporting Standards Board or a committee of the Board;
- (b) an exposure draft is prepared from the results of this study for consideration by the Board;
- (c) if it is approved, the exposure draft is distributed to interested parties and *Members' Handbook* subscribers, and published in the *Chartered Accountants' Journal*;
- (d) time is allowed for consideration and comment on each exposure draft;
- (e) the Board or its relevant committee will consider submissions received in response to the exposure draft, which is then revised as necessary;
- (f) provided that the revised draft is approved by the requisite number of Board members, it is submitted to the Accounting Standards Review Board for acceptance as an approved financial reporting standard under the Financial Reporting Act 1993 or to the Council of the Society for approval if it falls outside the jurisdiction of the Accounting Standards Review Board; and
- (g) following approval, the financial reporting standard will be included in the *Members' Handbook* and published in the *Chartered Accountants' Journal*.

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9 RELATIONSHIP OF NEW ZEALAND FINANCIAL REPORTING STANDARDS WITH INTERNATIONAL AND AUSTRALIAN ACCOUNTING STANDARDS

9.1 The international harmonisation of accounting standards is an objective of the International Accounting Standards Committee. The Society supports international harmonisation.

9.2 The Society will incorporate international accounting standards within the body of financial reporting standards, wherever possible.

9.3 Similarly, as a member of the International Federation of Accountants, the Society supports that body's Public Sector Statements by incorporating them within the body of financial reporting standards, wherever appropriate.

9.4 Both the Accounting Standards Review Board and its Australian counterpart, the Australian Accounting Standards Board, have an obligation under legislation to liaise with a view to harmonising New Zealand and Australian accounting standards. These two boards have issued a harmonisation policy. The Society supports the harmonisation policy.

9.5 A financial reporting standard is drafted only after a detailed consideration of the relevant International and Australian accounting standards. Therefore, conformity with New Zealand financial reporting standards will normally ensure compliance with International and Australian standards. Where differences exist, attention will be drawn to them in an appendix to the relevant financial reporting standard. If differences arise, then until such time as the Society issues new or revised standards, the existing New Zealand financial reporting standards will prevail.

10 OTHER SOCIETY PRONOUNCEMENTS

10.1 The Society may, from time to time, issue other pronouncements, such as interpretations of financial reporting standards, technical practice aids, technical guidance bulletins and guidance notes, which help to define generally accepted accounting practice in the particular area or sector to which they refer.

HISTORY

Previously issued explanatory forewords superseded by this Explanatory Foreword:

EX FWD/SSAP: Explanatory Foreword to Statements of Standards Accounting Practice (issued August 1978, revised April 1979).