

The text of New Zealand Cooperatives Association Executive Director Ramsey Margolis' speech to the General Assembly of the International Cooperative Alliance, Singapore, 19 October 2007.

Applying the international accounting standards to all cooperatives: the example of New Zealand

E nga mana, e nga reo, e nga rangatira maha, ka nui nga mihi atu ki a koutou kua hui mai nei i raro i te kaupapa o te mahinga kotahitanga.

No reira, tena koutou, tena koutou, kia ora mai ano tatou.

To the organisers, to the speakers, to all distinguished persons, greetings to you all, gathered here in the name of cooperatives.

Therefore, greetings, greetings, may we all be well.

The New Zealand and Australian governments are moving towards harmonising much of our commercial legislation to make the process of trade between our countries easier.

Included in this harmonisation is the adoption of identical accounting standards, with the NZ government embracing reporting under international accounting standards in 2002.

But first of all, some background. Our commercial general legislation as it affects cooperatives falls under the following principal Acts:

- the **Industrial and Provident Societies Act 1908** – an Act under which a number of older cooperatives are registered, particularly those in the not-for-profit sector.
- the **Companies Act 1993** – this is the overarching Act for the Cooperative Companies Act 1996. Based on Canadian legislation, the Companies Act does

not recognise nominal value shares, expecting shares to trade, or be dealt with, at their underlying or market value. This Act charges directors with completing a solvency test before making any distribution to its shareholders.

- the **Cooperative Companies Act 1996** – cooperative companies with limited liability are incorporated *both* under the Companies Act 1993 *and* the Cooperative Companies Act.
- the **Financial Reporting Act 1993** – this prescribes financial reporting requirements for issuers of securities and all other entities.
- the **Securities Act 1978** – an Act which establishes a Securities Commission and consolidates the law relating to the offer of securities to the public.

So, at the time of the introduction of the Companies Act in 1993, most New Zealand limited liability cooperatives operated on a nominal value share basis, with dollar in dollar out, and one vote per member.

The absence of this nominal value concept in the 1993 Companies Act meant that cooperatives could not continue to be structured like this, and they appealed to the Government. The government of the day took the previously unheard of step of allowing the NZ Cooperatives Association and our advisors to write our own Act, pulling together the various pieces of cooperative legislation into what became a single new Act, allowing for the continued practice of having nominal value shares.

In addition, what was the 1949 Cooperative Dairy Companies Act contained the right of a cooperative member who no longer had the ability to continue trading – sold their farm, retired or had died – to request that the company buy back, or redeem, their shares – a put option. This was included in our new legislation. And, of course, it is this put option which is causing cooperative equity in NZ to be considered debt under the new international accounting standards.

When the 1993 Companies Act was introduced, there was a period of grace to allow all companies to re-register under this Act. In the case of cooperative companies, of course, this meant re-registering under both the 1993 Companies Act *and* the 1996 Cooperative Companies Act.

This, however, required the writing of new constitutions, with many cooperatives writing into their constitution the put option contained in the new Cooperative Companies Act.

One way, then, that New Zealand cooperatives *might* be able to comply with international accounting standards is by amending their constitutions so that shares are *only* refundable with the agreement of the Board. Alteration of these constitutions, however, requires a special resolution with 75% of those present and voting in favour of any change.

This is an exceptionally high hurdle to achieve in cooperatives which might have up to 10,000 active members.

Now, the Financial Reporting Act requires that all entities that prepare financial reports must comply with NZ Generally Accepted Accounting Practice, or NZ GAAP.

With the decision to adopt international accounting standards in 2002, came the need for NZ GAAP to be based on these international standards.

In New Zealand, accounting standards are generally introduced through a two tiered structure.

Firstly, the New Zealand Institute of Chartered Accountants (ICANZ) has a Financial Reporting Standards Board, the FRSB.

Secondly the Financial Reporting Act sets up a specialist board, an Independent Crown Entity called the Accounting Standards Review Board, or ASRB. This body has *the statutory responsibility* of accepting accounting standards for application within New Zealand. It has *the statutory obligation* to ensure these standards, before adoption, have been available for positive comment and are appropriate for introduction to New Zealand.

The FRSB and the ASRB established protocols in 2002 for the introduction of international accounting standards. These protocols, amongst other things, charge the FRSB with *not* forwarding for adoption to the ASRB any accounting standard

based on an international accounting standard that *weakens* the reporting requirements of that international accounting standard.

The FRSB receives the standards from the International Accounting Standards Board (IASB) and, after initial review, circulates them for comment through the membership of ICANZ, and to other interested parties.

Currently, this disclosure period closes *before that of the IASB* and the FRSB review New Zealand comments, consolidate them and forward them on to the IASB, so that a genuine consulting process is followed.

During the transition periods, one of the standards which did not receive this scrutiny was IAS 32. As you are aware, the last substantive review of IAS 32 was conducted by the IASB in 2003. Submissions closed in London in October and the reviewed standard was released on 13 December 2003. In New Zealand, ICANZ, under its due process arrangements, released the standard for public comment in February 2004, with submissions closing in April 2004!

The NZ Cooperatives Association made submissions during the exposure period in NZ for IAS 32. The Association appeared in front of the FRSB to make its arguments, but we were unable to sway them, *possibly* because the FRSB was unable to weaken the reporting requirements of an international accounting standard.

Clearly, any submissions on IAS 32 made in New Zealand under our statutory processes were a waste of time. The FRSB could *not* forward them to the IASB for consideration as the IASB had *closed their comment period* some six and a half months prior!

The FRSB, aware of the difficulties IAS 32 created for cooperatives, established a working party with the New Zealand Cooperatives Association to look at presentational ways of solving the problem.

Whilst some presentation remedies were established, the FRSB was unable to concede they would be best practice as they were based on information being presented “on the face of” the Profit and Loss, or Balance Sheet, and would not endorse them.

At this point, the NZ Cooperatives Association petitioned the Government Minister of Commerce, who is responsible for cooperatives, for further help. The Minister agreed to promote a change to the Financial Reporting Act to allow the ASRB extra powers, which would give them the opportunity to exempt New Zealand cooperatives from the effects of IAS 32.

The New Zealand Cooperatives Association had been called before the FRSB in October 2006 and *asked by that body not to object* to the submission in respect of proposed amendments to NZ IAS 32 and NZ IAS 1 to accommodate Fonterra's fair value shares. At this meeting, the representatives of NZ Cooperatives Association asked the FRSB to support the change to the Act to allow limited exemptions in New Zealand.

The Financial Reporting Act was duly changed. However, late in the process, the amendment to the Act was changed in a way that it gave precious little benefit. It simply exempted directors from the *penalties* of non-compliance, rather than exempt cooperatives from a particular standard and allow for financial accounts then to comply with NZ GAAP.

There is another clause in the Financial Reporting Act that allows the ASRB to exempt bodies from the application of standards, but this has never been used and we are seeking to do so now. Whichever path is followed will require the ASRB to establish strong precedence to ensure the procedure is not abused. We are at this phase now.

During the last year, in the hope that the Cooperatives Association would not proceed with a formal application for exemption, the ASRB offered to establish a working party with members of the Cooperatives Association. This working party has been meeting since May in an attempt to try and find resolution. Resolution has not been achieved but a number of areas have been looked at.

We looked first of all at disclosure based methods, trying to discover a way of presenting accounts that would satisfy both the accounting profession and cooperatives. Looking for a disclosure-based solution we discovered that this explains the effect of IAS 32 but does not change the fact that shares remained debt

rather than equity, and this has a flow-on effect to the profit and loss account for associated transactions. Further, this inevitably distorts the profit and loss account.

The working group looked a number of possible side issues, such as the ability of minority shareholders to redeem their shares under sections 110 and 118 of the Companies Act 1993 in certain circumstances, which seemed to create a similar position to that in the Cooperative Companies Act – in other words, a *put* option. This did not give us the desired result, unfortunately.

The working group looked at the concept of statutory vs contractual liabilities as defined in IAS 32. We convened a meeting of the big four accounting firms, PWC, Deloitte, Ernst & Young and KPMG, along with the chairperson of the FRSB. The outcome was that this approach was *not* an option, as we were unable to sway their audit approach, as interpreted under IFRIC 2, that account preparers and auditors need to take account of all situations, including both “relevant local laws, regulations and the entity’s governing charter” when determining whether cooperatives shares are liabilities under IAS32.

This, of course, makes a mockery of the standards being written in the English language, for if they were the liability would be a “legal liability” and not contractual. Also, this points to the danger of international accounting standards becoming rules based if we need binding interpretations on how to interpret something purportedly written in the English language.

Very shortly, the Association will be applying to the ASRB for a determination under the Financial Reporting Act that the relevant sections of IAS 32 *not* apply to cooperative companies registered under the Cooperative Companies Act 1996 as well as industrial and provident societies registered under the Industrial and Provident Societies Act 1908 *that are members of the NZ Cooperatives Association*.

If the ASRB agrees, the result would be cooperative financial accounts that are compliant with NZ GAAP. In the long term, though, cooperatives in New Zealand are relying on the efforts of the ICA to bring some sense to this bizarre situation.

ENDS

Wellington, New Zealand • Thursday 4 October

telephone 00644 384 4595 • email ramsey@nz.coop • skype [nz.coop](https://www.skype.com/nz.coop)

Glossary

ASRB Accounting Standards Review Board

FRSB Financial Reporting Standards Board

IASB International Accounting Standards Board

ICANZ New Zealand Institute of Chartered Accountants

IFRIC International Financial Reporting Interpretations Committee

NZ GAAP New Zealand Generally Accepted Accounting Practice