

# Financial Reporting Adviser

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## Proposed changes to New Zealand's financial reporting framework

Recent announcements have now set the platform for a multi-standard approach quickly becoming a reality.

### Overview

Government announcements and discussion documents have just been released by the External Reporting Board (XRB) that outline significant change to the financial statement preparation and assurance requirements for many For Profit and Public Benefit Entities.

The Ministry of Economic Development has proposed a series of amendments to the statutory financial reporting framework in New Zealand (the "Framework") that is set out in the Financial Reporting Act 1993.

The Framework sets out the statutory requirement for preparation of annual general purpose financial reports (GPFR) in accordance with generally accepted accounting practice, and addresses the question: who should be required to prepare GPFR? The overarching objective of the proposed changes is to create a Framework that is

not only cost effective, but simple and clear to understand.

At the same time the External Reporting Board (XRB) released two Consultation Papers which address the question: what financial reporting standards will apply for entities preparing GPFR?

A number of changes from current reporting requirements will affect a range of different entities. The impact of changes will depend on the size, nature of operations, current basis for financial reporting and ultimately the needs of shareholders and users of the reporting entities financial statements. There are two major changes:

- Removal of the statutory obligation to prepare GPFR for small and medium sized For Profit companies
- Financial reporting requirements for charities have been clarified

The XRB's predecessor, the Accounting Standards Review Board, concluded in April 2011 that user-needs cannot be adequately addressed by a single set of accounting standards. Accordingly, two frameworks have now been proposed: one applied by entities with a For Profit objective, and an alternative set applied by entities with Public Benefit

objectives.

The closing date for submissions to the XRB on these proposals is 16 December 2011.

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# Proposed For Profit entity framework

## Current requirements

Presently almost all incorporated For Profit entities are required to prepare GPFR in accordance with Generally Accepted Accounting Practice in New Zealand (GAAP). Dependent on the nature and size of the organisation, applicable GAAP could either be “old NZ GAAP” (based on Financial Reporting Standards (FRS) issued by the New Zealand Institute of Chartered Accountants), “NZ IFRS” (based on International Financial Reporting Standards (IFRS) issued by the International Accounting

Standards Board), or a variation of either FRS or NZ IFRS because of differential reporting exemptions that were approved by the XRB and its predecessor.

## Reasons for change

Many reasons for changing the Financial Reporting Act and the standards approved under it have been given, but the two main ones were:

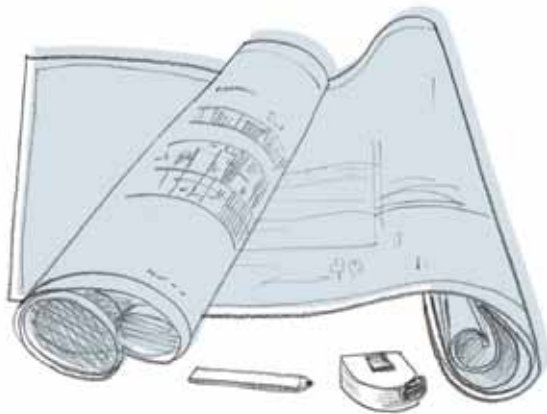
- The financial reporting obligations for small and medium-sized companies, that are non-issuers, have become over-complicated

- The elimination of the requirement to produce GPFR for small and medium-sized companies (SMEs) will reduce compliance costs because
  - (a) there will be a significant reduction in the amount of disclosures required
  - (b) SMEs will now have the ability to select accounting policies that are “fit for purpose”, rather than required by GAAP.

## Proposed framework

The proposed For Profit framework is displayed in the table below.

Class of entity	GPFR requirements	Audit	Filing requirements
Tier one			
Publicly accountable entities	NZ IFRS converged with IFRS	Yes	Yes (Companies Office)
Large For Profit public sector entities	NZ IFRS converged with IFRS	Yes	No (tabled in Parliament)
Tier two			
Large For Profit entities	NZ IFRS with disclosure concessions	Yes	No
Non large For Profit public sector entities	NZ IFRS with disclosure concessions	Yes	No (tabled in Parliament)
Non large For Profit entities with 10 or more shareholders/owners	NZ IFRS with disclosure concessions (but can opt out)	Yes (but can opt out)	No
Tier three - no requirement to prepare GPFR, but there will be Special Purpose Financial Reporting (SPFR) guidelines for tax purposes			
Non large For Profit entities with less than 10 owners/shareholders	SPFR (but can opt into the Framework)		



Refer to page 10 for a more detailed summary of proposed changes against current requirements.

### Publicly accountable entities

The definition of “publicly accountable” is fairly consistent with current definitions, which includes all issuers, registered banks, deposit takers and registered superannuation schemes. In the case of issuers, the Government intends to substantially change the Securities Act 1978 definition of “issuer” in securities legislation that it intends to introduce next year. The definition of an “issuer” for financial reporting purposes will be moved from the Financial Reporting Act to the amended Securities Act.

This will result in some entities no longer being defined as issuers, for example Retirement Villages defined as issuers under the Financial Reporting Act will only be defined as issuers under the Securities Act if they have issued debt or equity securities from the public.

### Large entities

A For Profit entity will be classified as large if it exceeds \$30 million revenue or \$60 million assets.

### NZ IFRS

Under the new Framework Tier One entities will be required to adopt NZ IFRS converged IFRS, supplemented by additional New Zealand specific standards and harmonised with

Australia.

Entities currently reporting under NZ IFRS will not experience significant change, however convergence with IFRS may result in the return of measurement and recognition options that had previously been removed under NZ IFRS (eg, IFRS allows investment properties owned by issuers, to be carried at either cost or fair value, but current NZ IFRS only permits accounting for them at fair value based on advice received from registered valuers).

### Reduced disclosure reporting (RDR)

The RDR approach proposed for Tier Two reporting uses the same measurement and recognition requirements as those required under full standards but significantly reduces disclosure requirements. This differs from the differential reporting framework we currently have in place in New Zealand which has some recognition and measurement concessions (eg, being allowed to account for income tax on a taxes payable basis).

### Opt-out rules

A shareholder motion is required for non-issuer For Profit entities not defined as economically significant (ie, large) to opt-out of preparation of GPFR and assurance requirements under the framework. The opt-out would succeed if 95% of the voting shares cast on the motion supported

the proposal.

### Special purpose financial statements

Special purpose financial reporting (SPFR) exists when financial statements are tailored to meet the specific information needs of a particular person or organisation. Special purpose users can specify the format and content of financial reports, including the accounting policies to be applied. SPFR statements have to be prepared in accordance with a predetermined GAAP. This means that entities can pick and choose the accounting policies that are best for them. However, when this is done, a full explanation of the accounting policies that have been used to prepare the special purpose financial statements will be required.



We understand that the New Zealand Institute of Chartered Accountants (NZICA) has been tasked with the development of best practice guidelines for SPFR for a number of industry groups including those who operate farms. NZICA has indicated that it will work closely with Inland Revenue and other users of financial statements, for example funding providers, to develop these guidelines. Broadly speaking:

- Inland Revenue will be determining what information is required for the SPFR for tax purposes, and what format these reports will take
- NZICA will be producing a set of guidelines to provide a consistent approach for the preparation of SPFR. To ensure these guidelines are fit for purpose, a working group with representation from the users of SPFR will be involved in the development of these guidelines
- NZICA is aiming to produce guidelines that will primarily focus on the needs of shareholders.

#### NZICA member considerations

Under the new framework many For Profit reporting entities will have no statutory requirement to prepare GPFR, however NZICA members will still be required to prepare GPFR where the potential users of the financial statements cannot specify the content of the financial statements (ie, users of the financial statements are not limited to a narrow set of stakeholders). If those who prepare financial

statements belong to NZICA, they will need to look past the statutory requirements of the framework and carefully consider the information needs of potential users and whether there are external users who have a need for the entity's financial statements but are unable to specify the content. If this is the case, then GPFR rules should be adopted.

#### Remaining financial reporting requirements

The proposals do not eliminate any of the responsibilities currently placed on directors under the Companies Act 1993. A company must always have accounting records that:

- (a) correctly record and explain the transactions of the company
- (b) will enable the financial position of the company to be determined with reasonable accuracy at any time.

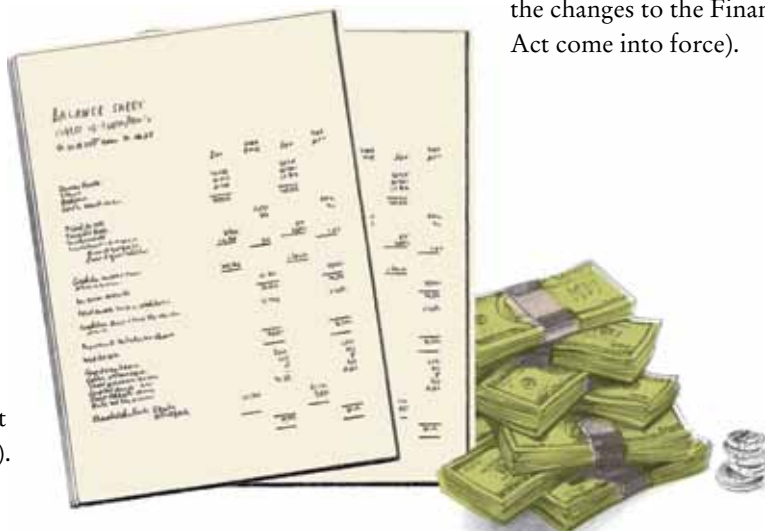
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Entities falling outside the framework may well opt to prepare GPFR and have them audited, to ensure the requirements of both the Financial Reporting Act and the Companies Act have been met.

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#### Implementation

It is expected that legislative changes to give effect to the Government's financial reporting framework will come into force mid 2013. It is anticipated that final decisions will be made available for early adoption for years beginning on or after 1 July 2012 with compulsory adoption for financial years beginning on or after 1 July 2013 (or a later date as the changes to the Financial Reporting Act come into force).



# Proposed Public Benefit Entity framework

## Entities captured by the framework

The current NZ IFRS definition of a Public Benefit Entity (PBE) will remain largely unchanged under the new regime and so the PBE definition below will still capture all entities in the Not for Profit sector.

“Public benefit entities are reporting entities whose primary objective is to provide goods and services for community or social benefit and where any equity has been provided with a view of supporting that primary objective rather than a financial return to equity holders.”

It will also include PBEs that operate in the public sector. These entities will continue to be referred to as “public entities” as defined by the Public Finance Act 2001.

In summary, all registered charities will have a requirement to prepare financial statements under the new Framework in one form or another.

## Current requirements

Registered charities are required to file financial statements annually with the Charities Commission. However, currently there are no standards to govern the basis for preparation of the financial statements of Not for Profit entities. The current Incorporated Societies Act 1908 and Charities Act 2005 include no provisions in relation to preparation and content of annual financial statements. This has led to uncertainty about what is required and inconsistencies in information reported by

similar charitable organisations.

It comes as a surprise to many that today there are no statutory obligations on registered charities to have an audit or a review engagement completed. Although many do, it is usually because their constitution requires it or their donors require it as a condition of granting money.

## Reasons for change

In releasing these proposals the Minister of Commerce noted the following:

- Introducing some simple format reporting requirements for medium and small-sized charities will make it easier for charities to meet current financial reporting requirements, and encourage consistent financial

reporting across the sector

- The current financial reporting system for Not for Profit entities is incomplete and lacks coherence
- The XRB considers that International Public Sector Accounting Standards (IPSAS) provides a better basis for PBE reporting than IFRS because the focus of IFRS is on For Profit reporting whereas the IPSAS reporting framework has been developed for a wider set of users, notably service recipients as well as resource providers

## Proposed framework

The proposed framework for PBEs is summarised in the table below.

Tier	Annual expenditure	Financial reporting	Audit
1	Over \$30M	NZ IPSAS with NFP application	Yes
2	Between \$2M and \$30M	NZ IPSAS with NFP application and disclosure concessions	Yes
3	Between \$40K and \$2M	Simple format accrual-based reporting	Audit or Review
3	Under \$40K	Simple format cash-based reporting	No (but can opt in)

Refer to page 11 for a more detailed summary of proposed changes against current requirements.

PBEs that are issuers should fall within the PBE framework rather than the For Profit framework and will report under Tier 1 regardless of size.

Financial statements prepared for Tier 3 entities would meet Charities Commission filing requirements, but would not be defined as GAAP.

In general, PBE's required to prepare financial statements within the framework will have a requirement to file audited financial statements with either the Companies Office, the Charities Commission or another registrar.

The Government is completing further consultation and analysis in 2012 to address the question of PBE audit requirements.

#### **NZ IPSAS with NFP application:**

International Public Sector Accounting Standards are an international set of financial reporting standards, closely aligned with IFRS and adapted for the requirements of the public sector.

IPSAS will be used as the base for NZ IPSAS, with adjustments for any recognition, measurement or disclosure matters considered inappropriate in the New Zealand context. The NFP application will include further modifications to NZ IPSAS required to address the user needs of NFPs, namely a few additions to cover specific NFP transactions not addressed by IPSAS

and further guidance for NFPs.

**Simple Format Reporting:** is a new form of financial reporting to be developed that will take a largely template approach and apply accrual and cash accounting principles. In broad terms the recognition and measurement requirements applying to Simple Format Reporting will be consistent to Tier 1 and Tier 2 entities. However, it is possible some concessions will be provided to reflect the "simple" nature of Tier 3 entities. It is envisaged Tier 3 requirements will be published in a separate set of standards.

#### **Large entities**

A PBE will be classified as large if it has operating expenditure in excess of \$30 million.

#### **Implementation**

The Charities Commission, NZICA, the XRB and selected Not for Profit organisations will work together to develop an appropriate support package to implement these proposals and minimise any compliance costs.

There will be a significant lead-in period to allow charities to adjust to the new requirements, with new requirements likely to apply from 1 July 2014 with early adoption permitted from 1 July 2013.



# Other changes

A number of smaller but collectively significant changes are being made that will improve the financial reporting system. A selection has been summarised below.

- The filing deadline for company financial statements will be reduced from five months to three months (for those entities required to file financial statements with the Registrar of Companies)
- Where a group of companies has reporting obligations, they will no longer be required to prepare a set of financial statements for the parent company. The obligation to prepare consolidated statements remains
- Large Limited Partnerships will have a new obligation to have an audit carried out by a registered auditor. The change will have a wider impact as entities transfer from a LAQC model to a Limited Partnership for tax purposes. Small Limited Partnerships will have no GPFR requirements

- Not for Profit entities can opt-out of audit if a simple majority (ie, 50% or more) of all members of the entity support the motion. Abstentions are a vote against the opt-out motion
- For Not for Profit entities with operating expenditure below \$150,000 per annum, an opt-out audit provision exists
- The monetary thresholds that are noted in the legislation will be amended every eight years and will be index-linked
- If an entity falls into two or more categories of reporting, then the higher or highest reporting obligation will apply
- Non-large For Profit entities can opt-out of an audit if 95% of the voting shares cast on a motion support the opt-out, whereas opt-in audit proposal requires 5% or more support

The key changes outlined in Government Cabinet papers and press releases have been reproduced in the table overleaf.

# Key changes for entities that have to report

Class of entity	Change and impact
Large companies	Remove the requirement to prepare parent entity financial statements and leave it to the External Reporting Board (XRB) to determine any parent company reporting obligations.
Medium-sized companies	Replace General Purpose Financial Reporting (GPFR) preparation requirements with Special Purpose Financial Reporting (SPFR) for tax purposes to minimum standards set by Inland Revenue.
Small companies	Replace simple format template reporting with SPFR for tax purposes to minimum standards set by Inland Revenue.
Issuers	The time within which companies, with preparation obligations, need to prepare financial reports will be reduced from five to three months.
Subsidiary companies	Where a group of companies has reporting obligations, they are no longer required to prepare a set of financial statements for the parent company. The obligation to prepare consolidated statements remains.
Medium and small limited partnerships	Replace the existing preparation requirement with special purpose reporting for tax purposes to minimum standards set by Inland Revenue.
Large trading trusts, limited partnerships and partnerships	Introduce requirements to prepare GPFR, have them audited and distribute to the owners.
Registered charities	Require the preparation of GPFR prepared in accordance with standards set by the XRB. The XRB has indicated that it is likely to use a simple format reporting approach for entities with operating expenditure <\$2 million.
Micro registered charities (annual operating expenditure ≤\$40,000)	Allow GPFR (which is likely to be simple format) to be prepared on a cash basis.
Medium and small industrial and provident societies	Retain a requirement to file an annual return with the Registrar but remove the requirement to include financial statements.
Friendly societies that offer insurance services, and credit unions	Retain the requirement to file audited financial statements but remove the requirement on the Registrar to monitor them and report to Parliament.
Other friendly societies	Retain preparation, assurance and distribution to members, but remove the filing requirement.
Gaming machine societies that operate gaming machines in commercial venues	Publication obligations vary according to the society's legal form. Introduce a consistent requirement to file audited financial statements.
Gaming machine societies that operate gaming machines almost exclusively in their own premises	Require societies to distribute audited financial statements to members but do not introduce a publication requirement.
Retirement villages	All retirement villages are treated as though they are "issuers". Remove that presumption for those that are not issuers in a real sense, which would allow the XRB to decide whether they could report in accordance with the second rather than the top tier of reporting.
Large Maori incorporations	In addition to the current preparation and audit requirements, require distribution to all beneficial owners.
Medium and small Maori incorporations	Remove the audit requirement.
Maori land trusts	Empower the XRB to set default reporting requirements, but allow the Maori Land Court to vary those requirements to meet individual circumstances.

# Grant Thornton's viewpoint

Releasing many SMEs from GPFR requirements (especially the burden of NZ IFRS) is a sensible and pragmatic move. However one of the hidden consequences of moving to SPFR is that there is no longer an automatic "rule book" to determine the basis for financial statement preparation. This can affect comparability, particularly when it comes to the recognition of revenue and expenses.

It will be very important that whatever guidance is issued on SPFR by Inland Revenue and NZICA is easy to understand and is not too far removed from IFRS so that there will

be consistency in financial statement preparation across various SME sectors.

The decision to follow Australia and put the focus entirely on group reporting, rather than parent and group reporting, is a decision that, in our opinion, is well overdue. We can see some compliance cost savings for many of our audit clients as a result of this decision. That said, we do have some doubts about the compliance cost savings that will be generated by the Reduced Disclosure Regime that was developed in Australia. Our experience suggests that most of the cost associated with preparing a set of financial

statements is incurred in determining the amounts to go into financial statements (ie, in the recognition and measurement of assets and liabilities) rather than in disclosure process that sits around it.

We are also pleased to see some sensible concessions being given to Retirement Villages because they are one group of reporting entities that we believe have been hit very heavily by demanding compliance requirements. It will be very important that Retirement Villages closely monitor the financial reporting concessions that are planned for Tier 2 entities.

## What should you do next?

As a result of the Government announcement the MED and XRB have released some very detailed papers explaining the costs and benefits associated with the changes noted above. Accompanying these

changes are another set of questions that both organisations have posed to ensure that what is planned to be put into legislation has no unforeseen consequences. Submissions are due no later than 16 December 2011.

Should you require assistance, please do not hesitate to contact your local Grant Thornton office, we would be pleased to help.



# For Profit changes

For Profit entities							
Current requirements				Proposed requirements			
Class of entity	Financial reporting	External audit	Filing requirements	Class of entity	Financial reporting	External audit	Filing requirements
Tier one							
Issuers or publicly accountable entities	NZ IFRS	Yes	Yes	Issuers or publicly accountable entities	NZ IFRS	Yes	Yes

Tier two							
Large: - Overseas-incorporated companies that carries on business in NZ - Subsidiary of a company incorporated outside NZ	NZ IFRS	Yes	Yes	Large: - Overseas-incorporated companies that carries on business in NZ - Subsidiary of a company incorporated outside NZ	NZ IFRS with RDR	Yes	Yes
Large companies with 25-50% overseas ownership interest	NZ IFRS	Yes	Yes	Large companies with 25- 50% or more overseas ownership interest	NZ IFRS with RDR	Yes	Yes
Other large non-publicly accountable companies	NZ IFRS	Yes (but can opt-out)	No	Other large non-publicly accountable companies	NZ IFRS with RDR	Yes	No
Large limited partnerships	NZ IFRS	No	No	Large limited partnerships	NZ IFRS with RDR	Yes	No
Large partnerships	No statutory financial reporting requirements			Large partnerships	NZ IFRS with RDR	Yes	No (distribute to partners)
Non large: - Overseas-incorporated companies that carries on business in NZ - Subsidiary of a company incorporated outside NZ	NZ IFRS	Yes	Yes	Non large: - Overseas-incorporated companies that carries on business in NZ - Subsidiary of a company incorporated outside NZ	NZ IFRS with RDR (but can opt out)	Yes (but can opt-out)	No
Other non-large companies	Old NZ GAAP	Yes (but can opt-out)	No	Other non-large companies with 10 or more shareholders	NZ IFRS with RDR (but can opt out)	Yes (but can opt-out)	No

No statutory requirement to prepare general purpose financial statements (It is envisaged these entities will prepare special purpose financial statements for tax purposes)							
Company defined as small (exempt Company)	Simple template reporting (FRO)	Yes (but can opt-out)	No	Non-large companies (including overseas-owned companies) with less than 10 shareholders	Can opt into Framework	No (but can opt-in)	No
Sole traders	No statutory financial reporting requirements			Sole traders	No statutory financial reporting requirements		
Non large limited partnerships and partnerships	No statutory financial reporting requirements			Non large limited partnerships and partnerships	No statutory financial reporting requirements		

Current requirements	Proposed financial reporting of large requirements
An entity is <b>large</b> if it exceeds any two of the following: (i) total assets of \$10M; (ii) annual revenue of \$20M; and (iii) 50 full time staff equivalents.	An entity is <b>large</b> if it exceeds \$30M revenue or \$60M assets at reporting date.

**RDR** is a Reduced Disclosure Regime (a form of differential reporting) that only provides disclosure concessions

**Publicly accountable** entities include issuers, registered banks, deposit takers, registered superannuation schemes and large For Profit public sector entities

**NZ IPSAS** is the New Zealand equivalent of International Public Sector Accounting Standards

# Public Benefit Entity changes

Public Benefit entities							
Current requirements				Proposed requirements			
Class of entity	Financial reporting	External audit	Filing requirements	Class of entity	Financial reporting	External audit	Filing requirements
Tier one							
PBE defined as an issuer or has coercive power to tax	NZ IFRS	Yes	Yes (Companies Office)	PBE defined as an issuer or has coercive power to tax	NZ IPSAS with NFP application	Yes	Yes (Companies Office)
Retirement villages that are issuers (defined by FRA)	NZ IFRS	Yes	Yes (Companies Office)	Retirement villages that are issuers (defined by securities law)	NZ IPSAS with NFP application	Yes	Yes (Companies Office)
Other retirement villages	NZ IFRS	Yes	Yes (Companies Office)	Retirement villages with annual expenditure over \$30M	NZ IPSAS with NFP application	Yes	Yes (Charities Commission)
Registered charities	No statutory financial reporting requirements		Yes (Charities Commission)	Publicly accountable entity with annual expenditure over \$30M	NZ IPSAS with NFP application	Yes	Yes (Companies Office)
				Tier two			
				Publicly accountable entity with annual expenditure between \$2M and \$30M	NZ IPSAS with NFP application applying RDR	Yes	Yes (Charities Commission)
				Other retirement villages	NZ IPSAS with NFP application applying RDR	Yes	No (distribute to residents)
				Tier three			
				Publicly accountable entity with annual expenditure between \$40K and \$2M	Simple Format Reporting (accrual basis)	Yes - (but can opt-out of audit if expenditure less than \$150K)	Yes (Charities Commission)
Publicly accountable entity with annual expenditure under \$40K	Simple Format Reporting (cash basis)	No (but can opt-in)	Yes (Charities Commission)				
Requirements of a selection of other Not for Profit entities							
Credit Union	NZ IFRS	Yes	Yes (Companies Office)	Credit Union	Tier 1 or Tier 2 dependent on size	Yes	Yes (Companies Office)
Maori Trust Boards	NZ IFRS	Yes	No (distribute to beneficiaries)	Maori Trust Boards	Tier 1 or Tier 2 dependent on size	Yes	No
Friendly Societies	Simple Format Reporting	Yes if receipts and payments both exceed \$50K	Yes (Registrar of Friendly Societies)	Friendly Societies	Simple Format Reporting	Yes (if expenditure exceeds \$150K)	Yes (Registrar of Friendly Societies)
Charitable Trusts that are not registered charities	No statutory financial reporting requirements			Charitable Trusts that are not registered charities	No statutory financial reporting requirements		
Incorporated and unincorporated societies that are not registered charities	No statutory financial reporting requirements			Incorporated and unincorporated societies that are not registered charities	No statutory financial reporting requirements		
Maori Reservations	No statutory financial reporting requirements			Maori Reservations	No statutory financial reporting requirements		

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