
REPORT 2
(1215/52/01/IM)

IMPLICATIONS FOR COUNCIL OF NEW AND PROPOSED FINANCIAL REPORTING STANDARDS

1. Purpose of Report

The purpose of this regular report is to inform the Subcommittee of new and proposed Financial Reporting Standards and their likely impact for the Council.

2. Recommendations

Officers recommend that the Audit and Risk Management Subcommittee:

- 1. Receive the information*
- 2. Note the developments in New Zealand generally accepted accounting practice (GAAP) since the last regular Subcommittee meeting in December 2009.*

3. Background

The Local Government Act 2002 requires the Council to comply with GAAP in preparing the Annual Report. GAAP is defined by the Accounting Standards Review Board (ASRB) to encompass all applicable Financial Reporting Standards (FRSs) and other sources of appropriate authoritative support (for example; exposure drafts of Financial Reporting Standards, International Accounting Standards etc).

Council Officers have undertaken to report to the Subcommittee on a regular basis in relation to any new FRSs and any exposure drafts currently on issue by the New Zealand Institute of Chartered Accountants (the Institute). This report outlines developments in GAAP and the implications for the Council since the last regular Subcommittee meeting on 4 December 2009. Developments in International Public Sector Accounting Standards (IPSAS) will also be presented to this Subcommittee for completeness.

4. Transparency, Accountability and Financial Management (TAFM) review

In October 2009 Rodney Hide, the Minister of Local Government, announced details of the proposed changes arising from the Transparency, Accountability and Financial (TAFM) review. The review proposes a series of changes to the Local Government Act 2002 (LGA) and is guided by the following three principles:

- Local government should operate within a defined fiscal envelope
- Councils should focus on core activities
- Council decision-making should be clear, transparent and accountable

There are a number of proposals which could affect the financial reporting area:

4.1 “Plain English” financial reporting

Including requiring councils to prepare a funding impact statement (FIS) for their annual plans and annual reports, at both a whole of Council and group of activity level, as well as disclosing information about reserve funds and internal loans.

4.2 Asset management information

Councils should disclose additional information around the level of planned and actual capital investment in infrastructure, splitting out investment to meet additional demand, investment to improve service standards and investment to replace existing assets. He is also proposing that the Auditor-General report separately on this information.

4.3 Pre-election report

Councils should publish a pre-election report (PER) to help promote election debate containing certain specified information for the previous three years and coming three years. We note that due to the proposed timing of the PER the most recent financial year’s information will not be audited and will therefore represent the best estimate of that information.

4.4 Long Term Council Community Plan (LTCCP) changes

There are a number of changes to the content of the LTCCP including:

- Community outcome process to be merged into the LTCCP planning process
- Inclusion of a financial strategy in the LTCCP
- Removal of some operational policies from the LTCCP
- LTCCP to focus on major issues, changes to service levels and cost and benchmark on critical performance measures
- LTCCP to be renamed the long term plan (LTP)

The TAFM bill has not yet been introduced and the Council are still reviewing the implications of these proposals from a financial reporting perspective.

4.5 *Benchmarking and major performance measures*

The proposal is to streamline non-financial performance reporting in long-term plans to focus on major issues, changes in service levels and cost, and benchmarking major performance measures. It proposes that Local Authorities work with Standards New Zealand to develop measurement standards.

5. Developments in Financial Reporting Standards

5.1 *Submissions Made*

The Council makes submissions on discussion papers or exposure drafts where there is potential for it to have a significant impact on either the Council as a reporting entity or the level of funding provided by ratepayers. We also consider whether the proposals are appropriate, in our opinion, from a standard setting perspective.

Since the last subcommittee meeting on 5 December 2009 the Council has made three submissions and has written one letter to seek further information and guidance. Copies of the full submissions and the letter are shown in Appendices 1 through 4 and are summarised below:

5.1.1 *Submission on Exposure Draft – ED 119 Proposed Amendment to NZ IFRS 3 – Scope Exemption*

The main issue faced by local authorities when accounting for amalgamations is that under NZ IFRS 3, the acquisition method must be used which results in one of the councils having to be recognised as the acquirer and the remaining councils as the entities being acquired. The fair value of the assets and liabilities of the acquired entities are then required to be measured and transferred to the acquiring council which would result in gains/losses representing the fair value of the acquired councils being recorded on amalgamation. Local authority entities recognised as acquirers are also be required to fair value all of their own assets and liabilities.

The exposure draft proposes that local government entities be exempt from the reporting requirements of NZ IFRS 3. The Council is in agreement with this proposal.

5.1.2 Submission on the ASRB discussion document on the proposed application of accounting and assurance standards under the proposed new statutory framework for financial reporting and on the MED discussion document on the statutory framework for financial reporting

On 30 September 2009 the Ministry for Economic Development (MED) and the Accounting Standards Review Board (ASRB) released two documents proposing changes to the financial reporting framework in New Zealand. The MED document contains proposed changes to who should be required to prepare and file general purpose financial reports (GPFR), and who will need to obtain assurance. The ASRB document proposes changes to what accounting standards should be used when preparing GPFR and the level of assurance to be obtained on those reports.

Key changes proposed in the MED document are as follows:

- The creation of a new External Reporting Board (XRB) responsible for the preparation and approval of accounting and assurance standards. This would consolidate the functions of the ASRB, Financial Reporting Standards Board and Professional Standards Board.
- The introduction of reporting tiers for public entities and private entities with different reporting and filing requirements for each tier.

Key changes proposed in the ASRB document are as follows:

- Some broad proposals for how the XRB, proposed in the MED document, might structure itself.
- Proposals for the assurance requirements and applicable financial reporting standards for the reporting tiers proposed in the MED document.

The proposals have significant potential impacts for the Council. Under the current financial reporting framework the Council reports under New Zealand International Financial Reporting Standards (NZ IFRS). Under the new framework all Local Authorities would have to report under International Public Sector Accounting Standards (IPSAS).

Although we acknowledge that there are some issues with the current framework and with the appropriateness of NZ IFRS for PBEs and believe that there is a need for specific PBE guidance in some areas, we still consider that a single set of standards for all sectors is the most appropriate approach to setting financial reporting standards in New Zealand.

We believe that the cost of transitioning to IPSAS and retraining staff would outweigh any benefits. As an alternative we would encourage the FRSB to work on filling the gaps in IFRS with public benefit entity specific standards and guidance. They have already started to do this with the recent release of an exposure draft which deals with income from non-exchange transactions (e.g. grants, donations, bequests) which are common types of transactions in the public sector.

We have a number of concerns with the proposals which are outlined in our submission:

- There would be minimal changes to the presentation of the financial statements of the Council and this proposal does not resolve the underlying issues with NZ IFRS and making our financial statements understood by ratepayers.
- Having separate sets of financial statements would force people to specialise so they do not have to learn multiple sets of standards and will make recruitment of staff more difficult. It will also require initial investment in training of current Council staff to ensure they are knowledgeable in the IPSAS standards.
- There are some concerns about the effectiveness of the IPSASB as it is currently only part time and has been slow to react to recent changes in the economic environment. Although there is currently a transition project being undertaken to update the IPSAS standards to align them more with IFRS this has taken a long time to achieve.
- We also have much less opportunity to get involved and influence standard setting for IPSAS. At the moment we have a lot of involvement in the standard setting process in New Zealand through officer involvement in the Public Benefit Entity Working Group.
- The Council also have involvement in the harmonisation of standards across New Zealand and Australia, which was something that the Prime Minister, John Key, also supported. There is no indication that Australia will be doing anything similar at the moment and we therefore believe that these proposals would lead us to distance ourselves from Australia and effectively make New Zealand become “standard takers” rather than “standard setters”.
- This would involve a further transition from NZ IFRS to IPSAS just a few years after the Council undertook the transition to NZ IFRS. This is a significant exercise for Council officers and is costly in terms of internal staff time and there are also likely to be additional audit fees.

5.1.3 Letter requesting further clarification on Exposure Draft – ED/2009/8 – Rate-regulated Activities

This exposure draft has been developed with the intention of giving guidance to entities that have rate-regulated activities. Rate regulation is a restriction on the setting of prices that can be charged to customers for services or products. An example would be utilities where a regulator is used to establish prices that are intended to be fair to both the entity and its customers.

Rate-regulated entities are able to adjust future income/fees to recover previously incurred costs or refund income collected in excess of costs. These entities would be required to recognise an asset or liability equal to the amount they would be able to recover or required to refund in future years.

The Council has written a letter seeking increased clarity on which entities would fall under this standard. We have sought external advice and believe that this standard is not intended to apply to the Council but the standard is not sufficiently clear to be able to confirm this.

5.2 Summary of Exposure Drafts reviewed since last Subcommittee meeting

There were a number of exposure drafts reviewed which have been divided between exposure drafts with a potential impact for the Council and those with limited or no expected impact.

5.2.1 Exposure drafts reviewed with potential impact for Council reporting

Exposure Draft/ Discussion Paper	Impact/Summary
ED 119 Proposed Amendment to NZ IFRS 3—Scope exemption	<p>The exposure draft proposes that local government entities be exempt from the reporting requirements of NZ IFRS 3.</p> <p>The main issue faced by local authorities when accounting for amalgamations is that under NZ IFRS 3 the acquisition method must be used which results in one of the councils having to be recognised as the acquirer and the remaining councils as the entities being acquired. The fair value of the assets and liabilities of the acquired entities are then required to be measured and transferred to the acquiring council which would result in gains/losses representing the fair value of the acquired councils being recorded on amalgamation. Local authority entities recognised as acquirers are also be required to fair value all of their own assets and liabilities.</p> <p>The Council is in agreement with the proposal that local government entities be exempt from the reporting requirements of NZ IFRS 3 and has made a submission on this exposure draft. See section 4.1.1 and Appendix 1 for more information.</p>
IASB ED/2010/1 Measurement of Liabilities	<p>The exposure draft proposes that the value of a liability should be measured at the amount that the entity would have to pay to relieve itself of the obligation. Estimates should take into account the time value of money and the risk that the actual outflows might ultimately differ from those expected. If the measurement of the expected outflows required is uncertain then the entity would measure based on their expected value. The expected value is</p>

based on a probability-weighted average of the outflows of a range of possible outcomes. It also allows an entity to incorporate a “risk adjustment” to account for the risk that the actual outflows of resources might ultimately differ from those expected.

If an obligation is to pay cash to another party, for example to settle a legal dispute, the future outflows used to measure the obligation would be the expected cash payments plus any associated costs, such as legal fees.

If an obligation is to undertake a service, for example to decommission a plant, then the outflows would be the amounts that the entity would pay a contractor at the future date to undertake the service on its behalf.

The Council appreciate that a probability based calculation of a provision would likely give a better estimate for a potential liability. However, we have some concerns over the difficulty and cost involved in obtaining multiple outcomes and deciding on their relative probabilities. There is also little guidance on how or when to apply the “risk adjustment”.

We also have concerns over the proposals to measure obligations to undertake a service. This affects the Council’s provision for landfill post-closure costs and would mean that, instead of calculating the provision based on an estimate of the Council’s future costs, this would now be based on amounts that the Council would pay a contractor at the future date to undertake the service on its behalf. This would involve the Council sourcing external quotes for post-closure work on landfills that we intend to do ourselves.

Under this exposure draft the Council would be required to include legal fees in its provisions and further work on contingent liabilities would be required to measure these on a weighted-average probability basis. At this stage we are

	<p>unsure of the value of the impact this exposure draft would have on the Council's financial statements.</p> <p>The Council is planning to make a submission on this exposure draft outlining the concerns that we have.</p>
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5.2.2 Exposure drafts reviewed with limited or no expected impact on Council reporting

Exposure Draft/ Discussion Paper	Impact/Summary
IASB ED 2009/6 Management Commentary (Guidance)	<p>The proposals in this exposure draft are for guidance only and are intended to apply to publicly listed entities only. The guidance has been created to assist entities with preparing management commentary that helps to place the related financial statements in context.</p> <p>While this guidance will not apply to the Council, we currently provide our users with commentary to assist them with understanding the Council's financial statements. Through the Long Term Council Community Plan (LTCCP) and Annual Plan we also provide detailed information on the Council's plans for the future and the related financial impacts of our service delivery plans.</p>

5.2.3 Exposure drafts relating to International Public Sector Accounting Standards (IPSAS)

At the moment there are no IPSAS exposure drafts.

5.3 Exposure Drafts on Issue

The following exposure drafts are currently open for comment and will be reviewed by the Council before the next subcommittee meeting:

- FRSB ED 120 on Proposed Amendments to NZ IAS 26 Accounting and Reporting by Retirement Benefit Plans
- IPSASB Consultation Paper, Reporting on the Long-Term Fiscal Sustainability of Public Finances
- IASB ED/2009/12 Financial Instruments: Amortised Cost and Impairment

We are currently reviewing these exposure drafts to determine any potential impacts on the Council. We will provide analysis of impacts for the Council and copies of any submissions made at the next Subcommittee meeting.

6. Conclusion

We will circulate any key documents to Subcommittee members as they become available. We will also continue to report developments in Financial Reporting Standards to the Subcommittee on a quarterly basis.

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Supporting Information

1) Strategic Fit / Strategic Outcome

The report supports Council's overall vision by ensuring that legislative compliance with GAAP (NZ IFRS) is appropriately managed.

2) LTCCP/Annual Plan reference and long term financial impact

The report has no specific Annual Plan reference. There is no long term financial impact arising from the report.

3) Treaty of Waitangi considerations

There are no specific Treaty of Waitangi considerations.

4) Decision-Making

There are no significant decisions required by the paper.

5) Consultation

a) General Consultation

There are no parties significantly affected by this paper.

b) Consultation with Maori

Maori are not significantly affected by this paper.

6) Legal Implications

This report has no specific legal implications.

7) Consistency with existing policy

This report is consistent with existing policy.

Appendix 1

Submission on Exposure Draft – ED 119 Proposed Amendment to NZ IFRS 3 – Scope Exemption

(1) Do you agree with the proposal in ED 119 to provide a scope exemption from NZ IFRS 3 Business Combinations for a local authority reorganisation where the assets and liabilities are transferred by a local authority to another local authority at no cost, or for nominal consideration, pursuant to legislation?

The Council agrees with the above proposal. Local authority reorganisations and amalgamations were considered by the IPSASB in 2009 when they introduced ED41 Entity Combinations from Exchange Transactions. During the submission process the IPSASB commented that the specific reporting requirements for non exchange transactions had not been addressed and therefore amalgamations of municipalities would not be within the scope of ED41. This issue is due to be considered by the IPSASB in 2010. It is therefore reasonable that an exemption from NZ IFRS 3 for local authorities is provided until the specific accounting issues arising from these combinations are considered by both the FRSB and IPSASB.

The main issue faced by local authorities when accounting for amalgamations is that the acquisition method must be used which results in one of the councils having to be recognised as the acquirer and the remaining councils as the entities being acquired. The fair value of the assets and liabilities of the acquired entities are then required to be measured and transferred to the acquiring council which would result in gains/losses representing the fair value of the acquired councils being recorded on amalgamation. Local authority entities recognised as acquirers are also be required to fair value all of their own assets and liabilities.

The Australian Accounting Standards Board (AASB) has specifically addressed the issues related to the amalgamation of local authorities by amending AASB3 Business Combinations and has added a specific consideration for local government entities. This allows them to transfer assets at the carrying value recognised by the transferor, or at their fair values. It does however still require that one of the local authorities is recognised as a transferee and this entity is required to record the carrying value of the assets transferred as a gain.

The Council recommend that the FRSB work together with the IPSASB and the AASB to develop a standard in New Zealand that it appropriate for local government entities and until this is completed local government entities should be exempt from the reporting requirements of NZ IFRS 3.

(2) In particular, do you agree that the use of the Local Government Act 2002 description of a local authority reorganisation is appropriate and workable in relation to the proposed scope exemption?

The Council agrees that the use of the Local Government Act 2002 description of a local authority reorganisation (see below) is appropriate as it appropriately outlines the types of proposals that are included within the scope of a local authority reorganisation and it is a definition that is already understood by the local government sector.

LGA 2002 Appendix A P24 Reorganisation proposals

(1) A reorganisation proposal may deal with any or all of the following matters:

(a) the union of districts or regions:

(b) the constitution of a new district or region, including the constitution of a new local authority for that district or region:

(c) the abolition of a district or region, including the dissolution or abolition of the local authority for that district or region:

(d) the alteration of the boundaries of any district or region:

(e) the transfer of a statutory obligation from one local authority to another:

(f) a proposal that a territorial authority assume the power of a regional council.

(3) Are there any regulatory issues or other issues arising in the New Zealand environment that may affect the implementation of the proposal, particularly any issues relating to the Privacy Act 1993?

The Council is not aware of any specific issues that may affect the implementation of the proposal.

(4) Do you consider that the proposed amendment is in the best interests of users of general purpose financial statements of entities in New Zealand?

The Council agrees that this proposal is in the best interests of users of general purpose financial statements in New Zealand. Until the specific issues facing local government in the application of this standard are addressed, it is inappropriate to require local authorities to comply with NZ IFRS 3, as the application of this standard will not result in more useful or understandable information for ratepayers.

This is particularly relevant at the moment with the Auckland 'Super City' amalgamation being planned. If the exemption was not granted, all of the entities forming the "Super City" would need to appoint one council as the acquiring entity. If this was Auckland City for example, Auckland would be required to fair value all of the assets and liabilities of the other councils and would record a gain equal to the fair value of the assets and liabilities from the other councils. The Council believe that this is likely to be confusing for readers and would potentially result in a higher depreciation charge for the combined entity.

There will also be a significant amount of work involved for local authorities to obtain valuations for assets and liabilities that are not currently recorded at fair value. These include land under roads and restricted assets. The requirement to fair value these assets during the amalgamation will be costly and will not provide more meaningful information for ratepayers.

(5) Do you consider that a local authority reorganisation which results in districts or regions being combined is a combination of entities under common control?

Based on the criteria currently included in NZ IFRS 3 Paragraph 10-13 which describes business combinations involving entities under common control, local authority reorganisations do not appear to meet the criteria.

Paragraph 10 states that “ *a business combination involving entities under common control is a business combination in which all of the combining entities or businesses are ultimately controlled by the same entity or parties both before and after the business combination...*” A local authority amalgamation does not meet these criteria because the local authorities would not all be owned by the same entity prior to the amalgamation.

(6) Do you consider that a local authority reorganisation which results in districts or regions being combined is an exchange or a non-exchange transaction?

The Council believe that a local authority reorganisation is most appropriately classified as a non exchange transaction. Non-exchange transactions arise when an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange. With local authority amalgamations the assets and liabilities are transferred from one local authority to another local authority at no cost, or for nominal consideration, pursuant to legislation, and so there is no exchange of equal value occurring.

(7) What, if any differences, do you see between a profit-oriented entity and local authorities that would warrant modifications to NZ IFRS 3 in respect of a local authority reorganisation?

The most significant difference between a profit oriented entity and local authorities is that local authority amalgamations normally do not require the purchase of the assets and liabilities, making them non-exchange transactions, which differ from profit entities where payment is usually required and would likely be classified as an exchange transaction.

(8) In your view, how should a local authority reorganisation be accounted for and reported?

The Council recommend that local authority transactions be accounted for in the following manner:

- The assets, liabilities and equity of all amalgamating entities should be combined to form a new entity at the carrying value of the assets and liabilities currently recorded in the financial statements of each of the entities. Where there are differences in accounting policies a decision should be made on the policies to be followed and any changes required to align the accounting policies should be accounted for at that time.

- Local authorities should not be required to record of a gain or loss equal to the carrying value of the assets and liabilities. Instead all of the assets, liabilities and equity would be amalgamated together in a new or existing entity.

Appendix 2

Submission on the ASRB discussion document on the proposed application of accounting and assurance standards under the proposed new statutory framework for financial reporting

General Framework for the Application of Accounting and Assurance Standards

Q1 Do you agree that the distinction between for-profit and public benefit entity sectors is a useful and cost-effective basis for classifying users and their information needs? If not what other basis would you suggest and why?

The Council agree that this is a useful and cost-effective basis for classifying users and their information needs.

Q2 Do you agree with the Board's view that the time has probably come for New Zealand to consider embracing sector-specific (rather than sector-neutral) accounting standards? If not, why not?

The Council have some concerns about New Zealand considering embracing sector-specific standards. Although we acknowledge that there are some issues with the current framework and with the appropriateness of NZ IFRS for PBEs and believe that there is a need for specific PBE guidance in some areas, we still consider that a single set of standards for all sectors is the most appropriate approach to setting financial reporting standards in New Zealand.

The Council believe that the cost of transitioning to IPSAS and retraining staff would outweigh any benefits. As an alternative we would encourage the FRSB to work on filling the gaps in IFRS with public benefit entity specific standards and guidance. They have already started to do this with the recent release of an exposure draft which deals with income from non-exchange transactions (e.g. grants, donations, bequests) which are common types of transactions in the public sector.

Other specific areas of concern are:

- There would be minimal useful changes for the reader in the presentation of the financial statements of the Council and we do not believe that this proposal resolves the underlying issues with IFRS and the difficulties we have in making our financial statements understood by ratepayers.
- Having separate sets of financial statements would most likely result in people specialising so they do not have to learn multiple sets of standards and will make recruitment of staff more difficult. It will also require initial investment in training of current Council staff to ensure they are knowledgeable in the IPSAS standards. There is also some concern that the public sector standards will be viewed as a second tier set of standards which are not as robust as IFRS.
- We have some concerns that the IPSAS board is only part-time. The review and development of financial standards is a continuous process and any standard setting body needs to be able to quickly respond to changes which can be difficult for a part time board. While there is currently a transition project being undertaken to update the IPSAS

standards to align them more with IFRS, this has taken a long time to achieve.

- Public benefit entities in New Zealand will have much less opportunity to get involved and influence standard setting for IPSAS. At the moment the Council have a lot of involvement in the standard setting process in New Zealand through officer involvement in the Public Benefit Entity (PBE) Working Group. This process has ensured that public benefit entity issues are considered and discussed on a regular basis. The Council believes that current issues with the standards for public benefit entities can be significantly reduced by more resource and effort being invested in the current NZ IFRS and FRS and an increased role for the PBE working group.
- The Council also acknowledges that there has been work undertaken on the harmonisation of standards across New Zealand and Australia – something that formed part of the role of the Accounting Standards and Review Boards and that the Prime Minister also supported. There is no indication that Australia will change its financial reporting framework, so we believe that the proposals would create further distance from Australia and effectively make New Zealand a ‘standard taker’.
- This would involve a further transition from NZ IFRS to IPSAS just a few years after the Council undertook the transition to NZ IFRS. This is a significant exercise for Council officers and is costly in terms of internal staff time and there are also likely to be additional audit fees. The Council believe that the change in standards will add costs to the Council without delivering noticeable benefit to the ratepayers of Wellington. The change is not expected to make our financial statements more “readable”.

Q3 Do you agree that: (a) using reporting Tiers is a cost-effective way to recognise the cost-benefit principle; and (b) the criteria for Tiers should be established on a sector specific basis? If not, what alternative approaches do you suggest and why?

The Council agree that using reporting tiers is a cost-effective way to recognise the cost-benefit principle. It is also appropriate to establish the tiers on a sector specific basis.

Proposed Accounting Standards Framework: For-Profit Entities

Q4 Do you agree that the distinction between publicly accountable entities (as defined by the IASB) and other entities should be used as the criteria to establish the for profit Tiers? If not, what alternative would you suggest and why?

The Council believe that this is an appropriate basis for establishing the for profit tiers as it helps to limit the reporting costs that would be imposed on small issuer entities.

Tier 1 – Issuers of securities traded in a public market and entities that hold assets in a fiduciary capacity as a primary business activity

Tier 2 – Issuers of securities that are not traded in a public market and non-issuing for-profit companies that are required to prepare GPFR and any other for-profit entities required to prepare GPFR.

Q5 Do you agree that, as small for-profit entities generally won't be required to prepare GPFR, only two reporting Tiers are necessary in the for-profit sector? If not, what would you suggest and why?

The Council believes it is appropriate to have only two reporting tiers in the for-profit sector as long as users of financial statements of entities with fewer than 10 shareholders are able to request that the entity opt in to tier 2.

Q6 Do you agree that (pure) IFRS should be used for reporting by Tier 1 for-profit sector entities? If not, what alternative would you suggest and why?

The Council agree that (pure) IFRS should be used for reporting by tier 1 for-profit sector entities. However if there are any significant issues relevant to New Zealand that are not covered by IFRS then tier 1 entities should also be required to follow those NZ specific standards.

Q7 (a) What factors (and their relative weighting) do you think the Board should take into account when choosing between the two reporting options for Tier 2 for profit entities (IFRS for SMEs; or a differential version of IFRS, ideally developed jointly with Australia)?

The board should take into account the cost of maintaining a differential version of IFRS. A review should be undertaken of the IFRSs for SMEs to determine whether there is any substantial difference between IFRS for SMEs and the current NZ IFRS differential reporting framework. New Zealand standard setters should also carefully consider the resource that will be dedicated to the preparation and ongoing maintenance of IFRS for SMEs and ensure that this will be adequate. Further research should also be done on whether Australia intends to adopt IFRS for SMEs. The New Zealand Government has signalled a desire to harmonise reporting with Australia and so a move to IFRS for SMEs rather than to a joint differential reporting approach may jeopardise this goal if Australia is not planning to do the same.

(b) What concerns of a material nature (if any) do you have about applying IFRS for SMEs? What are the reasons for these concerns?

The Council's main concerns with applying IFRS for SMEs would be:

- Changes are expected to occur only every three years which limits the ability to respond to changes in the current environment.
- Changes in full IFRS wouldn't automatically lead to changes in IFRS for SMEs and so the standards could become divided over time.

- It is likely that New Zealand would no longer have the same level of influence on the IFRS for SMEs as we currently have with the current differential reporting framework.
- This would move New Zealand further away from harmonising standards with Australia as there is no indication that they are planning to move to IFRS for SMEs.
- It is likely to be costly to maintain/update two sets of standards.

(c) What benefits do you perceive would result from a differential framework that is jointly developed between New Zealand and Australia?

The Council consider that there would be some key benefits of a jointly developed differential framework. The costs could be shared by New Zealand and Australia and the joint standards would significantly improve the comparability of the financial statements of New Zealand and Australian entities. This would be a significant step forward in the efforts to harmonise standards between New Zealand and Australia, which is something that is supported by the New Zealand government. We do note however, that a joint decision between New Zealand and Australia to both apply IFRS for SMEs would lead to the same result and would allow for more comparability of financial statements of SMEs around the world and would again reduce standard setting costs for both Australia and New Zealand. Our concern with this would be that New Zealand and Australia would not likely have the same level of influence on the IFRS for SMEs as we do with the current differential reporting framework.

Proposed Accounting Standards Framework: Public Benefit Entities

Q8 Do you agree that entity size (based on expenditure but not asset value), and in the case of public sector entities also the nature of the accountability relationship, should be used to allocate entities to the PBE sector Tiers? If not, what alternative would you suggest and why?

The Council agree that it is appropriate to allocate PBE entities to the PBE sector tiers based on expenditure and the nature of the accountability relationship.

Q9 Do you agree that for the PBE Sector Tier 1 should comprise entities with expenditure \geq \$20 million (public sector) or \geq \$10 million (not-for-profit sector) plus entities that are leviers of coercive revenue (regardless of size)? If not, what alternatives would you suggest and why?

The Council agree that it should be part of tier 1 reporting entities together will all entities that are leviers of coercive revenue.

Q10 Do you agree that Tier 3 should comprise entities with expenditure under \$2 million (public sector) or under \$1 million (not-for-profit sector)? If not, what alternative would you suggest and why?

The Council agree that the proposed criteria for tier 3 are appropriate. The majority of the users of the financial statements of these smaller entities are likely to only require simple format reporting. It however is important that the 'opt in' clause is included so that owners and users of financial statements that require more detailed reporting can request that these entities prepare their financial statements in line with the requirements for tier 1 or 2 if they wish.

Q11 Do you agree that: (a) a set of NZ PBE Accounting Standards should be developed for use by PBEs; (b) as part of this IPSAS be used as the basis for reporting in the public sector; and (c) a NFP Application (building on IPSAS) be used as the basis for reporting in the not-for-profit sector? If not, what alternative would you suggest and why?

The Council believe that it is most appropriate for PBEs and NFP in tier 1 to continue to use NZ IFRS as applicable for PBEs. If the tier 2 for-profit entities proceed with the use of IFRSs for SMEs rather than differential reporting, IFRS for SMEs could also be modified to include the same PBE exemptions used currently for NZ IFRS. It is unlikely that additional PBE exemptions, or modifications to the PBE exemptions used for tier 1 entities, would be required for tier 2 entities.

Q12 Do you agree that: (a) the full PBE standards should apply to Tier 1; and (b) a differential version of the PBE standards should apply to Tier 2 in the PBE sectors? If not, what alternative would you suggest and why?

The Council agree that the full NZ IFRS with PBE exemptions should apply to tier 1. It is also the Council's view that New Zealand should continue to require tier 2 entities to report under differential reporting rather than IFRS for SMEs. However, regardless of which standards are used for tier 2 entities, the same PBE exemptions should be applied as for tier 1 reporting entities.

Q13 Do you agree that 'Simple Format Reporting' should apply to Tier 3 entities in the PBE sectors? If not, what alternative would you suggest and why?

The Council agree that 'Simple Format Reporting' is appropriate for tier 3 entities because they are unlikely to have complex transactions. The users of their financial statements are unlikely to require a significant level of detail and disclosure over and above that required under simple format reporting.

Q14 Do you agree that PBEs that are issuers should continue to fall within the PBE sector requirements provided that they should never fall below Tier 2? If not, what alternative would you suggest and why?

The Council agree that it is appropriate for PBEs that are issuers to continue to fall within the PBE sector requirements. This will help to ensure that PBE financial statements are comparable across the sector. We also agree that PBEs that are issuers should never fall below tier 2 as simple format reporting is unlikely to include sufficient information for shareholders and bondholders.

The Proposed Assurance Framework

Q15 Do you agree that the same Tiers developed for accounting standard application should be used to determine assurance requirements? If not, what alternative would you suggest and why?

The Council agree that it is appropriate to use the same tiers to determine assurance requirements that are used to determine reporting requirements as it will make it easier for entities and users to understand.

Q16 Do you agree that a satisfactory matching of costs and benefits is achieved by requiring Tier 1 and Tier 2 entities to obtain audit engagements and Tier 3 entities to obtain review engagements? If not, what alternative would you suggest and why?

The Council agree that it is appropriate to require tier 1 and 2 entities to obtain audit engagements and to require tier 3 entities to obtain review engagements. Tier 3 entities are small entities with less complex transactions and the users are less likely to require a full audit engagement. The option is always available for stakeholders of tier 3 entities to request a full audit opinion at any time and 'opt in' to the tier 2 assurance requirements.

Q17 Do you consider that pure ISA and pure ISRE should be adopted as the basis for providing assurance on GPFR? If not, what alternative would you suggest?

The Council agree that it is appropriate to adopt pure ISA and pure ISRE from a cost benefit perspective, if there is no substantive difference between the New Zealand equivalent and pure ISA and ISRE. It will also ensure that the level of assurance provided on New Zealand financial statements is internationally consistent.

Related Issues and Comments

Q18 Do you agree that the XRB should: (a) have a 'safeguard authority' over the adoption of international standards that are inappropriate in a material respect in the New Zealand environment; and (b) the 'inappropriate in a material respect' test should apply to IFRS, IPSAS, ISA and ISRE? If not, what alternative (if any) would you suggest and why?

The Council agrees that the XRB should have a 'safeguard' authority over standards that are applied in New Zealand and believes that the New Zealand Accounting Standards Board would be an appropriate body to act as a

safeguard. An equivalent of the PBE working group should also continue in New Zealand to give guidance to the XRB on PBE specific issues.

Q19 Do you agree that provision should be made for additional New Zealand accounting and assurance standards to address areas not covered by international standards? If not, what alternative would you suggest and why?

The Council agree that it is essential for New Zealand to make provision for additional New Zealand specific accounting and assurance standards to address areas not covered by international standards such as FRS 39 Summary Financial Reports and FRS 42 Prospective Financial Statements.

Appendix 3

**Submission on the MED discussion document on the statutory
framework for financial reporting**

Institutions and statutory responsibilities (Part 3)

Q1 What comments do you have on the proposal to transfer the Institute's financial reporting and assurance standards responsibilities to a reconstituted ASRB?

This process appears reasonable as long as there is considerable involvement of the New Zealand Institute of Chartered Accountants with the newly formed XRB to ensure the views and ideas of the New Zealand accounting profession are well considered and that any decisions made are appropriate in a New Zealand context.

Q2 What comments do you have on the proposals for the manner of setting the number of tiers and the qualifying criteria for each tier?

The Council agree that it should be the same body given responsibilities for setting the number of tiers and defining the qualifying criteria for each tier. The Council also believe that it is most appropriate to give the XRB the power to make recommendations to the responsible minister to approve assurance and financial reporting standards.

Financial reporting principles and indicators (Part 4)

Q3 What comments do you have on the Primary Principle and the Indicators of financial reporting? Should any other principles and/or indicators be considered?

The Council is in agreement that the overarching reason for financial reporting is to provide information to external users who have a need for an entity's financial statements but are unable to request them. The availability of financial information to these users enables them to be able to make better economic decisions. The Council is also in agreement that the indicators proposed by the MED to determine whether an entity meets the primary principle are appropriate (public accountability, economic significance and the separation of ownership and management). These are similar to the indicators already used in the differential reporting framework in New Zealand.

Q4 What comments do you have on our broad conclusions in relation to preparation, publication and distribution?

The Council is in agreement with the broad conclusions. All issuers, public sector non-profit entities and private non-profit entities with charitable purposes that are not small should be required to prepare and publish general purpose financial reports (GPFR). The Council also agree that the costs for small non-profit entities are likely, in most cases, to outweigh the benefits to users. We believe that it is important that an opt-in clause is included for these small entities if they choose to prepare GPFR or are requested to do so by their owners or members.

The application of the indicators to for-profit entities (Part 5)

Q5 What comments do you have on the tests (annual income, total assets and employee numbers) for determining whether a for-profit entity is economically significant? What comments do you have on the two-out-of-three test or the alternative "revenue plus one other" approach outlined in Section 5.3.1? What comments do you have on the current thresholds of \$20m revenue, \$10m assets and 50 FTE employees?

The Council believe that it is appropriate to measure economic significance based on annual income, total assets and employee numbers. It is also appropriate that the two-out-of-three test is used. This is the same as the test already used in the differential reporting framework in New Zealand.

Q6 What comments do you have on the proposal to make no changes to the filing requirements for companies with 25% or more overseas ownership?

From a local government perspective there are no specific concerns with the proposals in this section.

Q7 What comments do you have on the proposal to remove filing requirements for overseas-incorporated companies whose New Zealand businesses are not large?

From a local government perspective there are no specific concerns with the proposals in this section.

Q8 What comments do you have on the preparation/opt-out and no-preparation/opt-in proposals for for-profit entities that meet the Separation Indicator only?

From a local government perspective there are no specific concerns with the proposals in this section. This proposal gives more flexibility to companies to decide whether or not they wish to produce GPFR.

Q9 What comments do you have on the criteria we have used to illustrate the proposals described in the previous question (i.e. (a) 10 or more shareholders for identifying companies with a significant number of shareholders; (b) 5% of voting shares by value for opt-in; and (c) no vote against for opt-out and opt-down)?

From a local government perspective there are no specific concerns with the proposals in this section.

Q10 What comments do you have on the proposal to remove the requirement for medium and small companies to prepare GPFR? What are the compliance cost implications?

The Council agree that it is appropriate to remove the requirement for medium and small companies to prepare GPFR. It is however important that there is a clear opt in provision for entities who see benefit in preparing GPFR and also for users of the financial statements of those entities to require GPFR. This proposal will help to align the reporting requirements of Australian entities with New Zealand entities.

Q11 What comments do you have on the Australian ‘grandfathering’ provision, exempting existing large companies at the time of the law change, from lodging financial statements with ASIC?

We understand that some large private companies may not wish to file GPFR if they have never done so, however, we believe that it would be fairer and easier to monitor if all existing large companies were subject to the same regulations and provisions.

Q12 What comments do you have on the advantages and disadvantages of requiring large non-issuer companies (and other entities impacted) to file financial statements under a ‘grandfathering’ regime?

If a company has been incorporated for a number of years and has not previously had a requirement to file, from the company point of view they may perceive that an advantage of the ‘grandfathering’ regime is that they can continue to be exempted from filing GPFR, thereby keeping their financial records private. However, this would lead to treatment not being consistent among all large companies as some companies may be forced to disclose sensitive information, which could be used by their competitors, while others would be exempt from making this information public.

Although some companies would perceive having to file GPFR as a disadvantage, we believe that a consistent approach should be favoured as it would ensure consistency and comparability among similar size companies.

The application of the indicators to public sector entities (Part 6)

Q13 What comments do you have on the proposal to retain the requirements for all public sector entities to publish assured GPFR?

The Council believe that it is appropriate to require all public sector entities to publish assured GPFR since they are all publicly accountable.

Q14 Do you consider that the changes outlined in Part 3 will provide an appropriate framework for public sector entity standards setting?

The Council believe that it is appropriate to establish a separate entity responsible for financial reporting strategy and for designing and approving financial reporting standards and assurance standards. We also believe that a separate committee be established, similar to the Public Benefit Entity Working Group, where public benefit entity specific issues can be addressed and considered. The Council’s preferred option is that public benefit entities

continue to report under NZ IFRS with specific public benefit entity exemptions. The Public Benefit Entity Working Group should be assigned resource under the new XRB to ensure all public benefit entity issues are actively considered and provided for in the standards.

The application of the indicators to private non-profit entities (Part 7)

Q15 What comments do you have on the proposal to use annual operating expenditure as the means for determining whether a private non-profit entity is small, medium or large?

The Council agree that annual operating expenditure is the most appropriate means for determining whether a private non-profit entity is small, medium or large.

Q16 What comments do you have on the proposals to use annual operating expenditure of \$20,000 and \$20 million as the cut off points between small and medium, and medium and large respectively? If you consider that other criteria should be used, what are those criteria and what cut-off points should be used?

Based on the data supplied on the distribution of PBE entities by expenditure in the ASRB discussion document – Proposed Application of Accounting and Assurance Standards under the Proposed New Statutory Framework for Financial Reporting (Table 3- Pg 36), a large proportion of small entities fall under the \$1m expenditure threshold (97%). The criteria being proposed by the MED is somewhat different to the ASRB document which proposes an upper threshold of \$10m for large private not-for-profit entities with a cut off of \$1m for medium and \$20k for small. We believe that it is reasonable that private not-for-profit entities with expenditure of less than \$20k should not be required to prepare GPFR and agree with the proposed tiers in the ASRB discussion document.

Q17 What comments do you have on the proposal that financial reporting obligations outlined in this Part would not apply to gaming machine societies?

From a local government perspective there are no specific concerns with the proposals in this section, there appears to be sufficient regulatory measures in place already.

Q18 What are your views on the preparation, distribution, publication and assurance proposals appearing in Part 7.6 and the Appendix insofar as it relates to private non-profit entities?

The Council believe that it is appropriate for there to be an option available to members of entities that have no mandatory financial reporting obligations to require that GPFR be prepared and audited.

The application of the indicators to Māori asset governance entities (Part 8)

Q19 What are your views on the proposal to make no changes in relation to Māori trust boards?

From a local government perspective there are no specific concerns with the proposals in this section.

Q20 What are your views on the proposals appearing in Part 8.3.1 in relation to Māori incorporations as summarised in Part 8.4?

From a local government perspective there are no specific concerns with the proposals in this section.

Q21 What are your views on the proposal to make no changes in relation to Māori reservations?

From a local government perspective there are no specific concerns with the proposals in this section.

Q22 What are your views on the proposal for the Māori Land Court to continue to have the responsibility for setting financial record keeping and reporting obligations for Māori land trusts?

From a local government perspective there are no specific concerns with the proposals in this section.

Q23 What are the advantages and disadvantages of requiring economically significant Maori land trusts to publish GPFR?

From a local government perspective there are no specific concerns with the proposals in this section.

Consequential issues (Part 9.1)

Q24 What are your views on the advantages and disadvantages of giving assurance standards the force of law?

An advantage of giving assurance standards the force of law if that it would help to ensure that individuals who do not follow assurance standards, and in turn sign off misleading financial statements, are prosecuted. We should ensure, however, that auditors are still allowed to apply professional judgement when carrying out engagements without the fear of prosecution.

Q25 What are your views on the proposal to make it an offence to unduly influence, coerce, manipulate or mislead an auditor?

The Council believe that it is appropriate to make it an offense to unduly influence, coerce, manipulate or mislead an auditor. The conclusion reached by

the auditor and expressed in the audit opinion may be materially influenced by misleading information which is why it is so important for auditors to be independent. An inappropriate audit report could lead to the users of the GPFR making poor decisions based on this incorrect information potentially cause financial loss.

Q26 What are your views on the proposal to make it an offence to recklessly or knowingly include false or deceptive matters in an audit report?

The Council agree that it is appropriate to make it an offense to recklessly or knowingly include false or deceptive matters in an audit report. Users of GPFR rely on this information to make sound financial decisions and stronger enforcement should deter individuals from misleading users of GPFR.

Q27 What are your views on the proposal to introduce a requirement to change statutory monetary thresholds within a certain time period? What are your views on the ten year proposal?

The Council agree that it is important to introduce a requirement to change statutory monetary thresholds regularly and agrees that every ten years is a reasonable timeframe.

Q28 What are your views on the proposals appearing in Part 9.1.3 concerning the three exemption powers for companies?

From a local government perspective there are no specific concerns with the proposals in this section.

Q29 What are your views on the proposed change to the solvency test?

The Council believe that the requirement to provide GPFR satisfies the requirement to prove whether a company is solvent. The GPFR require the confirmation that an entity is a going concern. In order to satisfy the going concern criteria, an entity is required to be solvent. Where an entity is not required to produce GPFR then their accounting records should be used.

Other issues (Part 9.2)

Q30 Do you consider that the parent company preparation and filing requirements should be retained, modified or removed? What are the compliance cost implications?

The Council believe that it is appropriate to retain the parent company preparation and filing requirements. From a ratepayer perspective the parent financial statements give ratepayers information about the financial results of the core Council's operations excluding the results of the subsidiary entities.

Q31 Assuming the parent company requirements were to be modified, what modifications should be made?

There are no specific modifications that the Council would recommend. We believe that the parent only financial statement preparation requirements should be retained.

Q32 What are your views on the proposal to require contributory mortgage brokers and the broker's nominee company to make GPFR available to investors?

From a local government perspective there are no specific concerns with the proposals in this section.

Q33 Do you consider that the filing deadline for entities with publication requirements should be reduced? What are your views on the IMF suggestion of four months?

The Council believe that the four month deadline for all entities preparing GPFR is reasonable and will help to ensure that more timely information is available to users. Under the requirements of the Local Government Act 2002, all local authorities are already required to produce their annual report within four months of the year end.

Q34 What are your views on the issues relating to remuneration disclosures for key management personnel?

These requirements do not currently apply Local Authorities and we would like clarification that these requirements will continue to exempt local government organisations. The Council however agree that it is reasonable to increase the limit to \$200,000 with a band of \$25,000. It also seems reasonable that this be reassessed every ten years.

New Zealand-Australia Single Economic Market (Part 11)

Q35 Do you have any comments on the proposals appearing in this document from a Single Economic Market perspective?

The Council believe that it is appropriate that entities with preparation obligations in both countries should be required to prepare only one set of financial statements in accordance with one set of standards and so, where possible, there should be a strong alignment of the financial reporting and assurance requirements for New Zealand and Australia.

Q36 Do you have any comments on the proposals in the table in the Appendix?

The Council has no specific additional comments on the proposals in the table as they relate to all of the items discussed above.

General question

Q37 Do you have any other comments?

The Council do not have any additional comments.

Appendix 4

**Letter requesting further clarification on Exposure Draft –
ED/2009/8 – Rate-regulated Activities**

29 January 2010

Simon Lee
Director - Accounting Standards
Institute of Chartered Accountants of New Zealand
PO Box 11342
WELLINGTON

Dear Simon

Letter regarding Exposure Draft ED/2009/8- Rate-regulated Activities

Wellington City Council (“the Council”) has reviewed the Rate-regulated Activities exposure draft, ED/2009/8 and is writing to request further clarification.

The Council sought external advice to assist in determining whether this exposure draft would apply to local government entities since we felt it was unclear from our reading of the document. The advice received has led us to believe that this was not intended to be applicable to local authorities but confirmed that some further clarification was required to confirm whether the proposed standard will apply to the Council.

As per the basis of conclusion BC10, the Council agrees that the intention of the exposure draft is to capture those commercial entities that *“have a monopoly or excessive market power (for example, electricity distribution utilities)”*. The examples included in the exposure draft also refer to entities that have a specific regulated body appointed to regulate the prices that the entity can charge while allowing them a fair return.

Our concern is that the two criteria outlined in the scope section (*“Paragraph 3”*), of the exposure draft may be interpreted broadly enough to also unintentionally capture some non commercial, local body authorities such as ourselves, that have the power to recover their expenditure through taxes or rates.

The rates that the Council charge are self regulated in that we are bound by the provisions of the Local Government Act 2002, the local authority’s long-term council community plan (LTCCP) and funding impact statement which is approved by the 12 member elected governing body. The Council sets the total amount of rates required to fund its expenditure based on the budgeted costs included in this 10 year plan. Paragraph 3(a) could be interpreted to apply to the Council, with the regulator being the Council’s governing body, which is required to approve the rates the Council is bound by. In reference to Paragraph 3(b), the Council’s rates are designed to recover the specific costs that the Council is planning to incur. While this would mean that the Council would fall within the scope of this exposure draft, the Council does not build in a specified rate of return which is also a requirement of paragraph 3(b).

Overall the Council do not believe that the exposure draft is intended to apply to local government entities but this is currently unclear from our reading of the exposure draft. We would recommend that some further guidance be included in the standard to clarify this.

If we can assist in any way please do not hesitate to contact me.

Yours sincerely,

Nicky Blacker
MANAGER - FINANCIAL ACCOUNTING
Wellington City Council