The great divide
The new financial reporting framework in New Zealand nears finalisation
June 2013
As the new financial reporting framework nears finalisation, it becomes more important than ever for organisations to ensure they fully grasp their future reporting requirements.

In this publication we provide an overview of the new financial reporting framework as it stands at June 2013, and summarise the impact the framework will have on for-profit and public benefit entities (PBEs). We also highlight the next steps in finalising the framework.

Statutory Financial Reporting Framework

In 2012, the Financial Reporting Bill (“The Bill”) was introduced into Parliament. The Bill reflects the Government’s proposed changes to the statutory financial reporting requirements concerning which entities are required to prepare General Purpose Financial Reports (GPFR), along with related audit and filing requirements. The Financial Markets Conduct Bill (‘FMC Bill’) is also currently before Parliament. The FMC Bill, through the definition of an FMC reporting entity, would extend the range of entities which currently have financial reporting obligations under the Financial Reporting Act 1993 by virtue of being an issuer.

On 22 May 2013, the Commerce Select Committee recommended in its report to Parliament that the Bill be passed as law with some amendments. Our summary of the Bill below incorporates the Commerce Select Committee’s proposed amendments.

Summary of the Financial Reporting Bill

One of the most significant changes from the current statutory financial reporting framework is that many small and medium-sized companies will no longer need to prepare GPFR. Instead, those entities will be required to prepare special purpose financial statements for tax purposes.

GPFR preparation, audit and filing requirements for companies and partnerships

The requirement to prepare GPFR will apply to:

- Issuers and other publicly accountable entities (e.g. banks and insurers).
- Large companies (i.e., companies with assets greater than $50m or revenue exceeding $30m). This also applies to large New Zealand companies with 25% or more overseas ownership. Large overseas companies that carry on business in New Zealand and large companies with 25% or more overseas ownership, unless the company is a subsidiary of an New Zealand company that has filed audited group financial statements.
- Other large companies and companies with 10 or more shareholders, unless:
  - The shareholders of the company opt out (i.e. by means of a resolution passed by not less than 95% of shareholders). This essentially maintains the status quo for these entities, which currently are able to opt out of an audit if all shareholders agree
  - The company is a wholly-owned subsidiary of a company that has filed audited group financial statements with the Registrar of Companies.
- Companies with fewer than 10 shareholders, but only if shareholders of the company who hold at least 5% of the voting shares require the company to have an audit.
- Large partnerships, including large limited partnerships, unless the partners opt out of an audit (i.e., by means of a resolution passed by partners with 95% of the firm’s capital).
- Entities that are issuers will continue to have filing requirements. The filing requirements for overseas companies carrying on business in New Zealand (and NZ companies with 25% or more overseas ownership) will be limited to companies that are large and are not a subsidiary of a New Zealand company that has filed audited group financial statements.

Other requirements

- Deadlines for preparation, audit and filing (where applicable) requirements for GPFRs are:
  - Four months for all issuers and other FMC reporting entities; and
  - Five months for other entities (currently 5 months for preparation plus 20 working days for filing for those required to file).
- Financial statements for a parent company do not need to be prepared if group financial statements are prepared.
- Retirement village operators will be removed from the definition of an issuer and hence will not automatically fall within the top tier of reporting. However, operators will still need to prepare GPFR and have an audit.
- Registered charities will be required to prepare GPFR.
- Friendly societies and branches are required to prepare GPFR unless a majority of the members opt out of compliance by way of a resolution. However, entities with operating expenditure over $30m cannot opt out of preparing GPFR. Additionally, friendly societies and branches that are issuers or issuers will continue to have financial reporting obligations.
- The Financial Markets Conduct Bill will be amended to require all credit unions to comply with the financial reporting obligations that will apply to issuers and other financial market participants.
- Legislative requirements for financial statements to a give a true and fair view will be removed. Instead, the requirements in applicable financial reporting standards (e.g. NZ IAS 1 Presentation of Financial Statements) will apply.
- Failure to comply with financial reporting obligations may result in an offence for both the company and its directors (rather than just the directors as is currently the case), with a maximum fine of $50,000 (rather than $100,000 under the 1993 Act).
Accounting Standards Framework
The External Reporting Board (XRB) is responsible for setting accounting standards for entities with a statutory requirement to prepare GPFRs. In 2011, the XRB announced its decision to move away from a single set of accounting standards for all entities to a multi-standards framework. Once fully implemented, the new accounting standards framework will require different sets of accounting standards to be applied by for-profit entities and public benefit entities (PBEs).

For-profit entities will remain on NZ IFRS standards, while PBEs will move to a new set of PBE accounting standards based on International Public Sector Accounting Standards (IPSAS).

Therefore, under the XRB’s multi-standards approach, determining whether an entity is a PBE or a for-profit entity will be the first step in establishing the particular financial reporting requirements for any entity that has a statutory requirement to prepare GPFRs.

The definition of a PBE is as follows: “PBEs are entities whose primary objective is to provide goods or services for community or social benefit, and where equity has been provided with a view to supporting that primary objective, rather than for a financial return to equity holders.”

Although this definition has not changed, it becomes more important – in the future, the classification of an entity as a PBE or for-profit will determine which set of accounting standard to apply.

The new multi-standards framework also introduces a tiered structure whereby entities will fall into Tier 1 by default, but can opt-in to a lower tier if they meet the criteria of that tier. The applicable accounting standard requirements for lower tiers have been tailored to generally better suit the user needs of entities meeting the lower tier criteria.

As at June 2013, the accounting standards for both Tier 1 and 2 for-profit entities and Tier 1 and 2 public sector PBEs have been issued.

The final stages in operationalising the new multi-standards framework are to issue the simple format reporting PBE requirements for Tier 3 and 4 PBEs and to revise the new PBE standards for private sector not-for-profit entities.

For-Profit Entities

<table>
<thead>
<tr>
<th>Entities</th>
<th>Existing Accounting</th>
<th>Proposed Accounting</th>
<th>Key Dates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier 1</td>
<td><em>“Publicly accountable” entities (as defined by IFRS, including entities deemed to be publicly accountable)</em></td>
<td>NZ IFRS (in most cases)</td>
<td>NZ IFRS</td>
</tr>
<tr>
<td>Tier 2</td>
<td>• All other for-profit entities required to prepare GPFRs in NZ IFRS</td>
<td>NZ IFRS or NZ IFRS differential reporting</td>
<td>NZ IFRS with Reduced Disclosure Requirements (NZ IFRS RDR)</td>
</tr>
<tr>
<td>Tier 3</td>
<td>• Entities that currently qualify for differential reporting</td>
<td>NZ IFRS differential reporting</td>
<td></td>
</tr>
<tr>
<td>Tier 4</td>
<td>• Entities that currently qualify to continue using old NZ GAAP</td>
<td>Old NZ GAAP</td>
<td></td>
</tr>
</tbody>
</table>

Public Benefit Entities

<table>
<thead>
<tr>
<th>Entities</th>
<th>Existing Accounting</th>
<th>Proposed Accounting Standards</th>
<th>Key Dates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier 1</td>
<td><em>“Publicly accountable” entities (as defined by IFRS, including entities deemed to be publicly accountable)</em></td>
<td>NZ IFRS for PBEs (usually)</td>
<td>Public Sector</td>
</tr>
<tr>
<td></td>
<td>• Large-sized entities (expenses &gt; $30m)</td>
<td>PBE Accounting Standards</td>
<td>Final standards issued</td>
</tr>
<tr>
<td></td>
<td>• Small entities (expenses ≤ $30m and ≤ $2m) that are not publicly accountable</td>
<td></td>
<td>Effective date 1 July 2014</td>
</tr>
<tr>
<td>Tier 2</td>
<td>• Medium-sized entities (expenses between $30m and $2m) that are not publicly accountable</td>
<td>Various (e.g. NZ IFRS for PBEs (full or differential reporting) or old NZ GAAP or no specific requirements)</td>
<td>NFP</td>
</tr>
<tr>
<td></td>
<td></td>
<td>PBE Accounting Standards with Reduced Disclosure Requirements (PBE RDR)</td>
<td>ED Q4 2013</td>
</tr>
<tr>
<td>Tier 3</td>
<td></td>
<td>Various (e.g. NZ IFRS for PBEs differential reporting or old NZ GAAP or no specific requirements)</td>
<td>PBE Simple Format Reporting – Accrual accounting</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Final standard Q4 2013</td>
</tr>
<tr>
<td>Tier 4</td>
<td>• Micro entities (expenses ≤ $125,000 and permitted by legislation to be in Tier 4) that are not publicly accountable</td>
<td>Various (e.g. NZ IFRS for PBEs differential reporting or old NZ GAAP or no specific requirements)</td>
<td>PBE Simple Format Reporting – Cash accounting</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Final standard Q4 2013</td>
</tr>
</tbody>
</table>

*The following entities would be deemed to be publicly accountable:
- All issuers (no matter what size)
- Registered Banks and Deposit Takers, as defined by the Reserve Bank Act 1999
- Registered Superannuation Schemes, as defined by the Superannuation Schemes Act 1999 unless exempted from the requirement to prepare GPFR

The great divide

The Bill also provides legislation to empower the External Reporting Board to issue financial reporting standards for a wider range of entities, including registered charities.
Impact of the proposed changes on for-profit entities

The changes to the financial reporting framework will have an impact on a wide range of for-profit entities. The only entities that will be largely unaffected are for-profit entities that are (and will continue to be) issuers or otherwise publicly accountable – they will continue to prepare GPFR in compliance with full NZ IFRS.

For-profit entities that qualify for and wish to opt into Tier 2 reporting requirements are now able to take advantage of the reduced disclosure concessions for Tier 2 for-profit entities (NZ IFRS RDR).

Some for-profit entities currently reporting under full NZ IFRS will be eligible to opt-in to Tier 2, such as large for-profit entities that are not issuers but currently do not qualify for differential reporting because of separation of owners and management.

For entities that currently use the differential reporting framework under NZ IFRS and that will continue to prepare GPFR under the new Tier 2 requirements (NZ IFRS RDR), there will be three main impacts:

- Fewer disclosure requirements – NZ IFRS RDR permits significantly less disclosure, compared with both full NZ IFRS and the current differential reporting framework. The key exception is the cash flow statement, which is required under NZ IFRS RDR.
- A loss of concessions relating to recognition or measurement – there are some, but not many, recognition and measurement concessions in the current differential reporting framework. For example, qualifying entities are not required to account for deferred tax. NZ IFRS RDR does not provide such concessions and requires the same recognition and measurement requirements as Tier 1 entities. This enables comparability and easy transition between Tier 1 and Tier 2, and minimises consolidation adjustments for groups. While some Tier 2 entities might be concerned about the loss of recognition and measurement concessions, many Tier 2 subsidiaries of Tier 1 parents will be unaffected, since many use the same accounting policies as their parent.
- Harmonisation with Australia – NZ IFRS RDR is largely consistent with the RDR framework in Australia. There are only a few differences between NZ IFRS RDR and the Australian RDR framework, to reflect regulatory differences. It is unlikely that an entity will move from differential reporting to full NZ IFRS under the new framework. However, if this situation did occur, there will be a number of implementation issues to address.

Small and medium-sized for-profit entities (SMEs) that will not be required to prepare GPFR under the new statutory framework will instead be required to prepare special purpose financial statements (SPFR) for tax purposes, using minimum standards set by the Inland Revenue Department (IRD). In order to set the minimum standards, the IRD is working with the New Zealand Institute of Chartered Accountants (NZICA) to develop a set of financial reporting guidelines for SMEs preparing SPFR.

In addition, some SMEs might choose to continue preparing GPFR, such as growing businesses, those planning an IPO, or entities seeking new investors that want GPFR. It should be noted, however, that “old NZ GAAP” will cease to exist once the new financial reporting framework comes into effect. Hence, any SMEs currently reporting under “old NZ GAAP” that choose to continue preparing GPFR will need to adopt NZ IFRS.

Impact of the proposed changes on public benefit entities

PBE Standards to be applied by Tier 1 and Tier 2 public sector PBEs have now been issued. These standards will be effective for public sector PBEs for annual accounting periods beginning on or after 1 July 2014, i.e., June 2015 balance dates onwards. Following revisions to the standards to include additional not-for-profit guidance, the standards will also apply to Tier 1 and 2 not-for-profit entities for periods beginning on or after 1 April 2015.

Entities will also have to prepare comparative figures for their first set of financial statements under PBE Standards.

The new PBE Standards are based on International Public Sector Accounting Standards (IPSAS) and comprise:

- New Zealand versions of IPSAS, with some modifications to particular IPSAS requirements for application in the New Zealand context.
- Standards based on IFRS for topics not covered in IPSAS, such as standards on business combinations, income tax and non-current assets held for sale.
- Domestic standards for other topics not covered in IPSAS or IFRS, such as the existing New Zealand standards FRS-42 Prospective Financial Statements and FRS-43 Summary Financial Statements.

Currently, there are few major differences between NZ IFRS (as applied by PBEs) and PBE Standards, but there are a relatively large number of minor differences. Consequently, the impact of the move from NZ IFRS to the new PBE Standards is not expected to be as great as the initial move to NZ IFRS. Nevertheless, all affected PBEs will need to carefully assess the impact for their organisation.

In addition, those PBE groups that include for-profit subsidiaries will need to continue to track relevant differences between NZ IFRS and the PBE Standards on an on-going basis, so that appropriate adjustments can be made for consolidation purposes. The differences between NZ IFRS and IPSAS are expected to increase in the future, because of the work programme of the International Accounting Standards Board (IASB) and the International Public Sector Accounting Standards Board (IPSASB). In particular, although the IPSASB uses IFRS as a base for the development of IPSAS, there is usually a time lag between the issue of an IFRS and the equivalent IPSAS. Currently, IPSAS is based on IFRS issued up to December 2008.

For PBEs currently using the differential reporting framework under NZ IFRS and that will be reporting under Tier 2 PBE accounting standards of the new financial reporting framework, the main impacts include:

- An overall reduction in disclosure requirements – the key exception being the requirement to prepare a cash flow statement under the PBE RDR standards.
- A loss of recognition and measurement concessions – the current differential reporting framework has some, but not many, recognition and measurement concessions.

There will be a simple format reporting approach for Tier 3 and Tier 4 PBEs. This will involve templates and simplified requirements for the financial statements. This should result in reduced compliance costs, especially compared with NZ IFRS. Tier 4 entities would prepare accounts on a cash basis.

Note: Impact of the proposed changes on for-profit entities

This section outlines the impact of the proposed changes on for-profit entities. The changes to the financial reporting framework will have an impact on a wide range of for-profit entities. The only entities that will be largely unaffected are for-profit entities that are (and will continue to be) issuers or otherwise publicly accountable – they will continue to prepare GPFR in compliance with full NZ IFRS.

For-profit entities that qualify for and wish to opt into Tier 2 reporting requirements are now able to take advantage of the reduced disclosure concessions for Tier 2 for-profit entities (NZ IFRS RDR).

Some for-profit entities currently reporting under full NZ IFRS will be eligible to opt-in to Tier 2, such as large for-profit entities that are not issuers but currently do not qualify for differential reporting because of separation of owners and management.

For entities that currently use the differential reporting framework under NZ IFRS and that will continue to prepare GPFR under the new Tier 2 requirements (NZ IFRS RDR), there will be three main impacts:

- Fewer disclosure requirements – NZ IFRS RDR permits significantly less disclosure, compared with both full NZ IFRS and the current differential reporting framework. The key exception is the cash flow statement, which is required under NZ IFRS RDR.
- A loss of concessions relating to recognition or measurement – there are some, but not many, recognition and measurement concessions in the current differential reporting framework. For example, qualifying entities are not required to account for deferred tax. NZ IFRS RDR does not provide such concessions and requires the same recognition and measurement requirements as Tier 1 entities. This enables comparability and easy transition between Tier 1 and Tier 2, and minimises consolidation adjustments for groups. While some Tier 2 entities might be concerned about the loss of recognition and measurement concessions, many Tier 2 subsidiaries of Tier 1 parents will be unaffected, since many use the same accounting policies as their parent.
- Harmonisation with Australia – NZ IFRS RDR is largely consistent with the RDR framework in Australia. There are only a few differences between NZ IFRS RDR and the Australian RDR framework, to reflect regulatory differences. It is unlikely that an entity will move from differential reporting to full NZ IFRS under the new framework. However, if this situation did occur, there will be a number of implementation issues to address.

Small and medium-sized for-profit entities (SMEs) that will not be required to prepare GPFR under the new statutory framework will instead be required to prepare special purpose financial statements (SPFR) for tax purposes, using minimum standards set by the Inland Revenue Department (IRD). In order to set the minimum standards, the IRD is working with the New Zealand Institute of Chartered Accountants (NZICA) to develop a set of financial reporting guidelines for SMEs preparing SPFR.

In addition, some SMEs might choose to continue preparing GPFR, such as growing businesses, those planning an IPO, or entities seeking new investors that want GPFR. It should be noted, however, that “old NZ GAAP” will cease to exist once the new financial reporting framework comes into effect. Hence, any SMEs currently reporting under “old NZ GAAP” that choose to continue preparing GPFR will need to adopt NZ IFRS.

Impact of the proposed changes on public benefit entities

PBE Standards to be applied by Tier 1 and Tier 2 public sector PBEs have now been issued. These standards will be effective for public sector PBEs for annual accounting periods beginning on or after 1 July 2014, i.e., June 2015 balance dates onwards. Following revisions to the standards to include additional not-for-profit guidance, the standards will also apply to Tier 1 and 2 not-for-profit entities for periods beginning on or after 1 April 2015.

Entities will also have to prepare comparative figures for their first set of financial statements under PBE Standards.

The new PBE Standards are based on International Public Sector Accounting Standards (IPSAS) and comprise:

- New Zealand versions of IPSAS, with some modifications to particular IPSAS requirements for application in the New Zealand context.
- Standards based on IFRS for topics not covered in IPSAS, such as standards on business combinations, income tax and non-current assets held for sale.
- Domestic standards for other topics not covered in IPSAS or IFRS, such as the existing New Zealand standards FRS-42 Prospective Financial Statements and FRS-43 Summary Financial Statements.

Currently, there are few major differences between NZ IFRS (as applied by PBEs) and PBE Standards, but there are a relatively large number of minor differences. Consequently, the impact of the move from NZ IFRS to the new PBE Standards is not expected to be as great as the initial move to NZ IFRS. Nevertheless, all affected PBEs will need to carefully assess the impact for their organisation.

In addition, those PBE groups that include for-profit subsidiaries will need to continue to track relevant differences between NZ IFRS and the PBE Standards on an on-going basis, so that appropriate adjustments can be made for consolidation purposes. The differences between NZ IFRS and IPSAS are expected to increase in the future, because of the work programme of the International Accounting Standards Board (IASB) and the International Public Sector Accounting Standards Board (IPSASB). In particular, although the IPSASB uses IFRS as a base for the development of IPSAS, there is usually a time lag between the issue of an IFRS and the equivalent IPSAS. Currently, IPSAS is based on IFRS issued up to December 2008.

For PBEs currently using the differential reporting framework under NZ IFRS and that will be reporting under Tier 2 PBE accounting standards of the new financial reporting framework, the main impacts include:

- An overall reduction in disclosure requirements – the key exception being the requirement to prepare a cash flow statement under the PBE RDR standards.
- A loss of recognition and measurement concessions – the current differential reporting framework has some, but not many, recognition and measurement concessions.

There will be a simple format reporting approach for Tier 3 and Tier 4 PBEs. This will involve templates and simplified requirements for the financial statements. This should result in reduced compliance costs, especially compared with NZ IFRS. Tier 4 entities would prepare accounts on a cash basis.
Next Steps

The Financial Reporting Bill is awaiting its second hearing before Parliament prior to becoming law. It must be enacted by 1 April 2015 at the latest. The starting date for the proposed changes would be as soon as possible after the legislation has been enacted and the minimum standards for entities preparing SPFRs have been set by the Inland Revenue.

For for-profit entities, NZ IFRS RDR for Tier 2 for-profit entities were issued in November 2012 and are available for early adoption. Once the Government enacts the proposed statutory reporting framework, Tiers 3 and 4 standards (NZ IFRS differential reporting and ‘old NZ GAAP’) will be withdrawn. Entities in those tiers that still have reporting requirements will have a one year period of grace after the legislative changes are enacted to move into either Tier 1 or 2.

PBE Standards to be applied by Tier 1 and Tier 2 public sector PBEs were issued in May 2013. Tiers 1 and 2 public sector PBEs will need to prepare their first set of financial statements under the new PBE Standards for periods beginning on or after 1 July 2014 (early adoption is not permitted).

The new suite of PBE Standards is expected to be revised for Tiers 1 and 2 not-for-profit entities, making them more applicable to registered charities and other not-for-profit entities by inserting additional application guidance for not-for-profit entities. It is expected these revised PBE Standards will be exposed for comment in the fourth quarter of 2013, and final standards issued in the fourth quarter of 2014. These standards will be effective for Tiers 1 and 2 not-for-profit entities for annual reporting periods beginning on or after 1 April 2015 (with early adoption permitted).

In December 2012, exposure drafts for the simple format reporting standards for Tiers 3 and 4 public sector PBEs and Tiers 3 and 4 not-for-profit PBEs were published for public consultation. Final simple format reporting standards are expected to be issued in the fourth quarter of 2013. The adoption of a multi-standards framework means that it is more important than ever for organisations to correctly determine whether they are for-profit or PBEs. For some entities this may involve revisiting the definition of a PBE to confirm their assessment. Once an entity has made this determination (and for any subsidiaries), we recommend all entities perform an impact assessment and develop a transition plan.

How we can help you

Ernst & Young’s Financial Accounting Advisory Services and Assurance professionals bring together a wealth of accounting knowledge from diverse experiences advising a range of clients across the public, corporate and not-for-profit sectors. We can help your organisation assess how the revised frameworks will impact your reporting obligations and assist with the interpretation and implementation of new accounting standards applicable to your organisation.

To help you prepare and plan for the new statutory financial reporting framework and accounting standards framework, we can assist with the following steps:

- **Entity type assessment** – a review of the entity’s assessment as a for-profit entity or public benefit entity
- **Initial diagnostic phase** – this would include a review of current accounting policies and an initial assessment of the impact of the new statutory reporting framework and accounting standards framework
- **Solution development** – identify specific areas of focus for the transition, consideration of the impacts on the financial statements and the processes and systems currently in place
- **Implementation** – assist to create new accounting policies, update financial information and systems and implement the transitional provisions, to help create an opening balance sheet
- **Post implementation** – monitor and assess the progress of adoption of new standards and ensure financial information produced is in line with the new requirements.

Contacts

For more information, please contact your usual Ernst & Young advisor or a member of the Financial Accounting Advisory Services teams

Kimberley Crook
Tel: +64 9 300 7094
kimberley.crook@nz.ey.com

David Pacey
Tel: +64 9 308 1084
david.pacey@nz.ey.com

Lara Truman
Tel: +64 274 899 896
lara.truman@nz.ey.com

Ravi Kumar
Tel: +64 212 214 717
ravi.kumar@nz.ey.com

Jude Doliente
Tel: +64 212 417 481
jude.doliente@nz.ey.com

David Bassett
Tel: +64 274 899 883
david.bassett@nz.ey.com
About Ernst & Young
Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 167,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organisation of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organisation, please visit www.ey.com.

© 2013 Ernst & Young, New Zealand.
All Rights Reserved.
SCORE No. NZ00000514.

This communication provides general information which is current as at the time of production. The information contained in this communication does not constitute advice and should not be relied on as such. Professional advice should be sought prior to any action being taken in reliance on any of the information. Ernst & Young disclaims all responsibility and liability (including, without limitation, for any direct or indirect or consequential costs, loss or damage or loss of profits) arising from anything done or omitted to be done by any party in reliance, whether wholly or partially, on any of the information. Any party that relies on the information does so at its own risk.

ED 0114