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NEW ZEALAND INSTITUTE OF CHARTERED ACCOUNTANTS

MEMORANDUM

DATE:	8 NOVEMBER 2005
TO:	MEMBERS OF THE IFAC INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS BOARD
FROM:	GREG SCHOLLUM, NEW ZEALAND REPRESENTATIVE
SUBJECT:	UPDATE ON RECENT DEVELOPMENTS IN NEW ZEALAND

Introduction

This memorandum updates Members of the International Public Sector Accounting Standards Board (IPSASB) on recent developments in New Zealand, specifically relating to:

- Generally Accepted Accounting Practice;
- Auditing and Professional Standards;
- Central Government; and
- Local Government.

Generally Accepted Accounting Practice

Establishment of PBE working group

The Financial Reporting Standards Board (FRSB) has established a Public Benefit Entity Working Group (PBEWG). The objective of the PBEWG is to assist the FRSB to ensure that financial reporting pronouncements applicable in New Zealand (particularly in relation to the NZ version of IFRS (NZ IFRS) :

- are relevant to, and will enable public benefit entities (PBEs), including both public sector entities and not-for-profit entities, to prepare high quality financial information,
- are appropriate to PBEs, and
- address financial reporting issues faced by public benefit entities in a comprehensive and timely manner (subject to available resources).

The members of the working group comprise people working in central government, local government, not-for-profit sector, academia, and in accounting practice (big 4), and include Kevin Simpkins and myself. Ken Warren is chairing the working group.

The main projects on the PBE Working Group work plan are:

- Non-exchange Revenue (including consideration of the IPSASB ED);
- Equity;
- Reporting by voluntary sector entities; and
- Performance reporting (including non-financial performance reporting, financial performance, and implications for the Framework);
- Revision of the NZ Equivalent to the IASB Framework for the Preparation and Presentation of Financial Statements.

At this stage the PBEWG is proceeding with the non-exchange revenue project on the basis that it will give rise to a new NZ Financial Reporting Standard. (If this occurs, this will be the first time that an IPSAS has been adopted in its entirety in NZ.)

Prospective Financial Information

The FRSB issued ED-103 *Prospective Financial Information* in May 2005. ED-103 outlined proposed changes to FRS-29, the existing financial reporting standard dealing with prospective financial information. (FRS-29 provides guidance to entities publishing prospective financial information to audits and may prove useful when the IPSASB initiates phase 2 of the Budget Reporting project.)

The review of FRS-29 was prompted by:

- issues arising from an enquiry by the Securities Commission. This enquiry highlighted some uncertainty regarding the distinction between projections and forecasts; and
- concerns raised by the Office of the Auditor-General about the appropriateness of some of the requirements in FRS-29 for public sector entities – in particular local authorities. The Local Government Act 2002 requires local authorities to prepare a Long Term Council Community Plan every three years covering a period of not less than 10 consecutive financial years. Forecast information included in that plan is required to be prepared in accordance with generally accepted accounting practice. In addition, from 2006, such plans are required to be audited.

ED-103 carried forward many of the requirements of FRS-29. However, there were some important differences. ED-103:

- attempted to clarify the application of the standard to particular types of published prospective financial information;
- stated that in order to meet the needs of users, general purpose prospective financial information is expected to be understandable, relevant, reliable and comparable (ie. consistent with the qualitative characteristics in the Framework);
- removed the distinction between forecasts and projections;
- specified what constituted a complete set of prospective financial statements but did not require an entity to prepare a complete set of prospective financial statements; and
- contained many of the disclosure requirements in FRS-29. However, ED-103 focused more on disclosing the level of uncertainty associated with prospective financial information.

The FRSB agreed to proceed with developing a standard based on ED-103 which will provide guidance to both profit-oriented and public sector entities. Factors that were considered by the FRSB in making this decision included:

- the majority of respondents supported the FRSB's proposals to issue a revised FRS-29;
- there are practical difficulties associated with preparing information under the existing standard;
- the imminent need for guidance for local authorities; and
- harmonisation of securities legislation and regulations with Australia is likely to take some time.

At this stage, the main change to the proposals outlined in ED-103 is that the FRSB is proposing to require that entities preparing prospective financial information present a complete set of prospective financial statements.

Control

Application of FRS-37 has highlighted issues around whether the definition of control is working as originally intended, particularly in respect of public sector entities established to operate with a large degree of autonomy and independence (eg. Universities, the Reserve Bank).

In August 2005 the FRSB issued for comment a Discussion Paper *Control and Public Benefit Entities that have Autonomy and Independence*. The purpose of the Discussion Paper is to raise issues for consideration by constituents and to request feedback on the preliminary views of the FRSB outlined in the Paper on the application of FRS-37 *Consolidating Investments in Subsidiaries* and NZ IAS 27 *Consolidated and Separate Financial Statements* to public sector entities created with statutory independence or autonomy.

In NZ the issue of whether or not the Crown should consolidate all Tertiary Institutions including universities has been particularly controversial.

The Discussion paper is available on the Institute's web site www.nzica.com

Proposed Amendments to NZ IAS 1

The Accounting Standards Review Board (ASRB) has approved Proposed Amendments to NZ IAS 1 *Preparation of Financial Statements*. The proposed amendments:

(i) require entities to disclose, in the notes to the financial statements, that the financial statements have been prepared in accordance with NZ GAAP, together with a description of the financial reporting standards applied by the entity (for example, whether the entity is a public benefit entity and has applied NZ IFRSs as appropriate for public benefit entities); and

(ii) include, as an appendix, application guidance on determining when an entity is a Public Benefit Entity.

Differential Reporting

In December 2004 the FRSB issued for comment ED-98 *Framework for Differential Reporting for Entities Applying the New Zealand Equivalents to International Financial Reporting Standards Reporting Regime* (2005) *(Framework for Differential Reporting)*.

The FRSB finalised the Differential Reporting Framework in May 2005 and it was approved by the ASRB in June 2005.

This Differential Reporting Framework explains differential reporting and its application in the context of New Zealand equivalents to IFRS, the specific Financial Reporting Standards applicable to entities that have adopted New Zealand equivalents to IFRS and the New Zealand Equivalent to the IASB *Conceptual Framework for the Preparation and Presentation of Financial Statements*. This *Framework for Differential Reporting* sets out the concessions available under this reporting regime to qualifying entities required to prepare general purpose financial statements that comply with Generally Accepted Accounting Practice in New Zealand.

This *Framework for Differential Reporting* represents an interim approach to the development of differential reporting concessions for entities applying New Zealand equivalents to IFRS while we await developments with the IASB's SME project. It is based on the *Framework for Differential Reporting* initially developed in 1994. A discussion of the assumptions used in developing that Framework and supporting the use of the surrogates for assessing the benefits and costs of financial reporting requirements are set out in sections 3 and 4 of that Framework. In developing the latest *Framework for Differential Reporting* the FRSB has not re-examined these assumptions because a review of qualifying entities and differential reporting concessions is likely to be required in the short term.

New Zealand Equivalent to IFRS 7 Financial Disclosures

The FRSB has submitted NZ IFRS 7 to the ASRB for approval and proposes, as an interim step, subject to a brief exposure, to require financial institutions that elect to adopt NZ IFRS 7 early, to also continue to apply NZ IAS 30.

The FRSB also agreed to develop an exposure draft proposing that NZ IFRS 7 be amended by including an appendix specifying New Zealand specific disclosures for financial institutions.

The FRSB agreed that in developing the exposure draft proposing additional disclosures for financial institutions the following matters should be considered:

- whether there is any need to specify the location of disclosures in order to enhance comparability;
- the rationale for additional disclosures. The FRSB considered that additional disclosures are not justified merely because they have been required in the past, but that they must reflect good accounting;
- the systems implications of proposals. That is, how difficult will it be for financial institutions to obtain information in the proposed categories, whilst simultaneously meeting the requirements of IFRS 7 and other IFRSs; and
- the possible implications of Basel II on prudential supervision.

Puttable Instruments

At the September 2005 IASB meeting, staff of the FRSB presented to the IASB proposed amendments to IAS 32 to affect the classification of:

(a) instruments puttable at a pro rata share of the fair value of the issuer ("puttable at fair value");
(b) instruments with obligations for a pro rata share of issuer's net assets, payable upon liquidation of the issuer, when liquidation is certain (affects limited life entities);
(c) instruments with obligations for a pro rata share of issuer's net assets, payable upon liquidation of the issuer, when liquidation is at the option of the holder (affects partnership interests);
(d) minority interests in consolidated financial statements, when minority interests are puttable at fair value or payable on liquidation (and liquidation of the subsidiary is certain or at the option of the holder).

At present, those instruments are classified as financial liabilities under IAS 32 which is of major concern to the country's co-operative entities. Under the proposed amendments, the instruments above would be classified as equity in limited circumstances.

The IASB decided to proceed with the short-term project to amend IAS 32 to reclassify from liabilities to equity, in limited circumstances, a particular class of instruments, which represent a residual interest in the issuer (e.g. the instruments are the most subordinated class of instruments, and payments to instrument holders are not limited or guaranteed either before or on liquidation).

Staff intend to present any remaining issues arising from the proposed amendments to IAS 32 at a future IASB meeting.

Accounting by Trusts

The FRSB has considered the issues raised by constituents in the submissions received on Exposure Draft *Guidance Notes on the Application of Generally Accepted Accounting Practice by Trusts*. The FRSB agreed that further consideration needs to be given to some issues, such as the definition of 'owners', in the context of trusts. The FRSB proposes to issue a communiqué to advise constituents of its plans for the project and to express its views on some points arising from its discussion of comments received.

Auditing and Professional Standards

Adoption of International Standards on Auditing (ISAs)
The Professional Practices Board (PPB) published an Invitation to Comment: Adoption of International Standards on Auditing.

The consultation phase is now complete. The PPB's intention is that the adoption process will be aligned with the timeframe for the IAASB's project to improve the clarity and structure of International Standards.

The IAASB Chairman (John Kellas) and Technical Director (James Sylph) are participating in two Institute seminars for New Zealand audiences (members, practitioners and other interest groups), planned for mid-November. The purpose of the seminars is to promote awareness of the IAASB and its current projects and future plans, and to communicate the planned implementation of the project to adopt the International Standards during 2006 and 2007.

Central Government

New Zealand has a mixed member-proportional system. A general election was held on 17 September 2005 and a Labour led Government continues in power with the benefit of confidence and supply agreements with several minor parties.

The Financial Statements of the Government of New Zealand for the year ended 30 June 2005, were published on 24 September 2005. These financial statements are prepared in accordance with NZ GAAP, and received an unqualified audit opinion. They can be accessed from http://www.treasury.govt.nz/financialstatements/year/jun05/.

In most respects the financial statements comply with IPSAS. There are however a number of exceptions where the financial statements do not comply with IPSAS:

- The Financial Statements do not assert compliance with IPSAS (IPSAS 1, para 26)
- Amounts of assets and liabilities expected to be recovered before or after 12 months from the reporting date are not disclosed. (IPSAS 1, para 68) The order of liquidity presentation method is used.
- Breakdowns of receivables and payables are included in the notes rather than the face of the accounts. (IPSAS 1, para 89)
- There is no explicit discussion in the accounts about what each reserve represents. Note the only reserves relate to asset revaluation reserves (IPSAS 1, para 97)
- The entities comprising the Government are listed but not an explicit description of overall operations and principal activities (IPSAS 1, para 133). This would entail considerable narrative disclosure.
- Net exchange differences are not classified as a separate component of net assets/equity nor are exchange differences disclosed as part of the disclosure of assets. (IPSAS 4, para 61)
- Tertiary institutions and School Board of Trustees have a reporting date of 31 December while the consolidated accounts are prepared as at 30 June. This has meant a difference between reporting dates of more than 3 months. Funding flows and expenditure are adjusted to June. (IPSAS 6, para 43)
- There is no separate disclosure of details of finance leases although the few finance leases disclosed within the Crown may be too immaterial to warrant this type of disclosure. Nor is there a general description of significant leasing agreements as logistically there are too many leasing arrangements to be able to disclose the arrangements with any ease.(IPSAS 13, para 32 and 36)

- Detailed information on movements of property plant and equipment and some other information is shown by total property plant and equipment rather than by class of property plant and equipment (IPSAS 17, para 33 and 34)
- Cost of acquiring assets during the period is not disclosed as part of the segmental information. (IPSAS 17, para 55).

Local Government

Local authorities are preparing for the adoption of NZ IFRS - in particular establishing the opening balance sheet position (as at 1 July 2005) for the comparative period. Local authorities will be publishing their first set of NZ IFRS financial statements for the period ended 30 June 2007.

Local authorities are also preparing for the next Long Term Council Community Plan (LTCCP) and the audit thereof. The next LTCCPs (10 year plans) need to be adopted by Councils before 30 June 2006.

If you have any questions about any of these matters please feel free to raise them with me.

Greg Schollum
NEW ZEALAND REPRESENTATIVE