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WEEKLY COMMENT: FRIDAY 19 APRIL 2013

1. Last week I looked at the *Financial Markets Conduct Bill* (the “FMC Bill”) as reported from the Commerce Committee on 7 September 2012. I also looked at *Supplementary Order Paper No. 93* to the Financial Reporting Bill (the “FR SOP”) released on 31 July 2012, which contained amendments to the FMC Bill relating to reporting requirements for issuers and other financial markets participants (now incorporated into the version of the FMC Bill reported from the Commerce Committee).
2. This week I look at the *Financial Reporting Bill* (the “FR Bill”), on which the report from the Commerce Committee is due on 28 May 2013. Next week I will finish reviewing the triumvirate of Bills by looking at the *Companies and Limited Partnerships Amendment Bill* (the “CLP Bill”), as reported from the Commerce Committee on 1 December 2012.

The Financial Reporting Bill

3. The *General policy statement* in the *Explanatory note* states the objective of the FR Bill is to require an entity to prepare financial statements only where any of 3 indicators that financial reporting is in the public interest are met:
 - (a) The entity is **accountable to the public**:
 - (i) Because it is owned by taxpayers and ratepayers (such as government departments, Crown entities and local authorities); or
 - (ii) Because it has sought funding through debt or equity instruments offered to the public (entities covered by the provisions of the FMC Bill and the reporting requirements set out in the FR SOP, as discussed last week); or
 - (iii) Because it takes deposits from the public, or holds assets in a fiduciary capacity for broad groups of outsiders (for example, banks, insurers, and mutual funds); or
 - (iv) It receives donations and bequests direct from the public - a main change in the Bill being a requirement for registered charities to adhere to financial reporting standards issued by the *External Reporting Board* (the “XRB”); specified non-profit entities – those with total operating payments of \$40,000 or more for the immediately preceding 2 accounting periods – must prepare financial statements in accordance with generally accepted accounting practice (“GAAP”); (see paragraphs 26 onwards below).
 - (b) The entity is **economically significant** because it is a large entity, or a large overseas company. A large entity is one where:

- (i) At the balance date of each of the two preceding accounting periods, the total assets of the entity and its subsidiaries (if any) exceed \$60 million; or
 - (ii) In each of the two preceding accounting periods, the total revenue of the entity and its subsidiaries (if any) exceeds \$30 million.
- (c) Due to the **separation between ownership and management**, owners or members of an entity are likely to need financial statements. Accordingly the requirements to prepare general-purpose financial statements cover:
- (i) A company with 10 or more shareholders, unless shareholders holding 95% of the votes “opt out” of compliance under the “opt out” rules for a company that is not an issuer; or
 - (ii) A company with fewer than 10 shareholders where shareholders holding at least 5% of the voting shares “opt in” and require the company to comply with general-purpose financial reporting requirements.
4. Apart from the above, the **major impact of the FR Bill will be to remove the requirement for non-large non-issuer companies to prepare general-purpose financial reports**. Although, as noted above, companies can “opt in” to the reporting requirements.
5. The FR Bill widens the powers of the XRB to issue financial reporting standards for a range of entities. It also changes the organisation of financial reporting legislation: only core financial reporting principles and definitions that are intended to apply to more than one class of reporting entities (such as the definition of “large”) will be included in the Financial Reporting Act itself. All substantive reporting requirement and related offence provisions to be covered in sector, industry, and entity- specific Acts:
- (a) The Companies Act 1993 (FR Bill, Part4, Subpart 3).
 - (b) The Partnership Act 1908 (FR Bill, Part 4, Subpart 9).
 - (c) The Limited Partnerships Act 2008 (FR Bill, Part 4, Subpart 8).
 - (d) The Charities Act 2005 (FR Bill, Part 4, Subpart 2).
 - (e) The Building Societies Act 1965 (FR Bill, Part 4, Subpart 1).
 - (f) The Friendly Societies and Credit Unions Act 1982 (FR Bill, Part 4, Subpart 4).
 - (g) The Industrial and Provident Societies Act 1908 (FR Bill, Part 4, Subpart 7).
 - (h) The Gambling Act 2003 (FR Bill, Part 4, Subpart 5).
 - (i) The Retirement Villages Act 2003 (FR Bill, Part 4, Subpart 10).
 - (j) The Te Ture Whenua Maori Act 1993 (FR Bill, Part 4, Subpart 11).
 - (k) The Income Tax Act 2007 – the accounting standards test for the active income exemption for CFCs (FR Bill, Part 4, Subpart 6).

Commencement date

6. The new Financial Reporting Act comes into force on 1 April 2015. However, various portions of the new Act will come into force on different dates appointed by the Governor-general by 1 or more Orders in Council.

Tiers of financial reporting

7. The XRB is to continue to implement the strategy for establishing different tiers of financial reporting as set out in sections 34 to 34D of the *Financial Reporting Act 1993*. In November 2012, the New Zealand Accounting Standards Board (“NZASB”) issued the For-Profit Package of standards that apply to for-profit entities preparing general-purpose financial statements in accordance with GAAP. The For-profit Package will be followed by two other packages for public sector public benefit entities and not-for-profit entities.
8. These packages establish the new tiered structure. Standard XRB A1 (FP Entities Update) applies for reporting periods beginning on or after 1 December 2012 and establishes a four-tier structure for for-profit entities:
 - (a) Tier 1: Full NZ IFRS is the default tier – entities in Tier 1 will have to prepare financial statements applying full NZ IFRS.
 - (b) Tier 2: NZ IFRS RDR is a Reduced Disclosure Regime (“RDR”), which can apply to an entity that does not have public accountability (as defined) or which is a public sector entity with expenses less than \$30 million. This regime has the same recognition and measurement requirements as Full NZ IFRS but with an estimated 50% fewer disclosures, depending on the specific circumstances of the entity. Hence the costs of preparing financial statements for Tier 2 entities are potentially significantly less than for Tier 1 entities.
 - (c) Tier 3: NZ IFRS Differential Reporting is the same as under the old framework, and is a “temporary tier” until the FR Bill is enacted, because following enactment, the majority of small and medium-sized companies will no longer have to prepare general-purpose financial statements.
 - (d) Tier 4: Old GAAP is another temporary tier and applies to entities that previously applied old GAAP, and which will be able to continue doing so until they do not have to prepare general-purpose reports once the FR Bill gets enacted.

Non-financial reporting and non-GAAP standards

9. The FR Bill provides for financial reporting standards to cover reporting on an entity’s service performance, related party transactions, or other non-financial matters. The Governor-General can authorise the Board issue financial reporting standards relating to reporting on an entity’s governance, strategic direction, or any other matters.
10. A financial reporting standard may be a non-GAAP standard and may apply to an entity even if the financial statements of the entity are not required to comply with GAAP.

Current reporting and registration obligations

11. Currently, the FRA 1993 distinguishes between a “reporting entity” (which includes an issuer, a company other than an exempt company, and a person required by any other Act to comply as a reporting entity), and an “exempt company”, which is defined in section 6A of the FRA 1993 as:
 - (a) A company that is not an overseas company or an issuer; and
 - (b) A company that satisfies at least two of the following criteria:
 - (i) At balance date, total assets did not exceed \$1 million; and/or

- (ii) For the accounting period the turnover did not exceed 42 million and/or
 - (iii) At balance date the company had 5 or fewer full-time employees; and
 - (c) At balance date the company was not a subsidiary of another company and did not have any subsidiaries of its own.
12. Under s. 10 of the FRA 1993 reporting entities must prepare financial statements that comply with GAAP, and have them signed by at least 2 directors (if there is more than 1 director) within 5 months after balance date. Exempt companies, on the other hand, are given up to 9 months after balance date to prepare financial statements and have them signed (providing all shareholders agree to the extension). In addition, the financial statements of an exempt company need only comply with the lesser requirements set out in the *Financial Reporting Order 1994*.
13. Section 18 of the FRA 1993 requires an issuer to deliver its financial statements to the Registrar for registration within 20 working days after the date they are required to be signed. An issuer must appoint an auditor and have its financial statements audited, under s. 196 of the *Companies Act 1993*.
14. Under s. 19 of the FRA 1993, an overseas company, a subsidiary of an overseas company, or any “large” company in which 25% or more of the voting power is held by non-residents, must deliver their financial statements to the Registrar for registration within 20 working days after the date they are required to be signed. (For this purpose a company is “large” if two of the following criteria are met: total assets at balance date exceed \$10 million; turnover for the accounting period exceeds \$20 million; 50 or more full-time employees at balance date.) A company that is subject to the registration requirements of s. 19 of the FRA 1993 must have its financial statements audited, under s. 196 of the *Companies Act 1993*.

New reporting and registration obligations

15. Under Part 6A of the FMC Bill as reported from the Commerce Committee, an issuer is an FMC reporting entity to which the reporting rules in Part 6A of the Bill, as initially set out in the FR SOP, will apply. Refer to paragraph 22 onwards of last week’s *Weekly Comment* (12 April 2013).
16. Note that the FRA 1993 will continue to apply to an issuer in relation to securities issued prior to the commencement of the transitional provisions of the FMC Bill until all of those securities are cancelled, redeemed, or forfeited, or all of the obligations owing under those securities have been discharged (clause 44 of Schedule 5 of the FMC Bill).
17. Furthermore, under cl. 57 of the FR Bill, the FRA 1993 continues to apply to an issuer for all accounting periods that end before date specified in regulations made under cl. 57 of the FR Bill.
18. Apart from issuers, general-purpose financial reporting obligations are imposed, under replacement s. 196 of the *Companies Act 1993* contained in cl. 86 of the FR Bill, only on:
- (a) A “large” company; and
 - (b) A “large” overseas company that carries on business in New Zealand; and
 - (c) A company with 10 or more shareholders (unless the shareholders “opt out” of compliance – see paragraph 3(c)(i) above); and

- (d) A company with less than 10 shareholders if holders of at least 5% of the voting rights require the company to comply (i.e. “opt in”).
19. For the purpose of counting shareholders to see if the 10-shareholder threshold is breached, joint holders of a parcel of shares are counted as a single shareholder. The meaning of “large” is set out in paragraph 3(b) above.
20. Except for a company that is an issuer or for a “large” overseas company, there is a significant relaxation to the requirement to have accounts audited. The requirements for a company that is an issuer, or for a “large “ overseas company, to have its accounts audited and registered with the Registrar is unchanged.
21. For all other companies, it will be possible to “opt out” of the audit requirement if 95% of holders of voting rights elect to do so. “Large” companies (that are not overseas companies) may opt out of the audit requirement under replacement s. 207I of the *Companies Act 1993*. Companies with 10 or more shareholders may opt out under replacement s. 207H. And companies with less than 10 shareholders may “opt in” under replacement s. 207J.
22. The existing requirements to prepare audited financial statements and have them registered with the Registrar will be removed for an overseas company that is not “large”, and for an overseas company’s New Zealand subsidiary to which the requirement to prepare financial statements would not otherwise apply.
23. The audit and registration requirements are being retained for a “large” overseas company, a large company that is at least 25% owned by non-residents, and for an overseas company’s New Zealand subsidiary to which the requirements to prepare financial statements under the FR Bill will otherwise apply.
24. Apart from issuers, the reporting obligations for partnerships and limited partnerships apply only to “large” entities as defined in paragraph 3(b) above. Large partnerships and large limited partnerships have the ability to “opt out” of the audit requirements by resolution passed or signed by partners entitled to at least 95% of the capital of the firm (for ordinary partnerships), and by partners who together have contributed at least 95% of the capital contributions of all the partners (for a limited partnership).
25. Entities subject to the reporting requirements under the FR Bill, and that have not opted out if able to do so, will have only 3 months following the balance date within which to have the accounts prepared and signed by the directors. The timeframe for delivery to the Registrar for registration will remain 20 working days following the date by which the financial statements were required to be signed.

Reporting requirements of registered charities

26. A charitable entity will be required to include a copy of the financial statements for the most recently completed accounting period with its annual return. Section 41 of the *Charities Act 2005* is being amended accordingly by cl. 76 of the FR Bill.
27. Cl. 77 of the FR Bill inserts a new s. 42A into the *Charities Act 2005* which states that in the case of a *specified non-profit entity*, the financial statements must be prepared in accordance with GAAP. As set out in cl. 45, an entity is a “specified non-profit entity” in respect of an accounting period if, in each of the 2 preceding accounting periods of the entity, the total operating payments of the entity are \$40,000 or more.

28. The XRB has advised on its website that the standards that will apply to entities that will be in Tier 1 or Tier 2 under the new Accounting Standards Framework are the Public Benefit Entity Standards (PBE Standards) and the PBE Standards Reduced Disclosure Regime (PBE Standards RDR) respectively.
29. Draft PBE Standards/PBE Standards RDR were issued as part of the Public Sector PBE Package in June 2012. However, those draft standards were focused primarily on public sector PBEs. The NZASB is currently working on enhanced version of those draft PBE Standards that will be equally applicable to NFP entities. The XRB expects that Exposure Drafts (EDs) for those enhanced PBE Standards will be issued for comment in mid-late 2013.
30. In the case of a charitable entity that is not a specified non-profit entity, new s. 42A(1)(b) of the *Charities Act 2005* states that the financial statements must be prepared in accordance with either GAAP or a non-GAAP standard that applies for the purposes of the section.
31. The XRB has released proposed standards for Tier 3 and Tier 4 NFP entities and invited comments by 28 June 2013.
32. In the case of either a specified non-profit entity, or any other charitable entity, the knowing failure to comply with the applicable financial reporting standard or non-GAAP standard will, under new s. 42B of the *Charities Act 2005*, result in fine, upon conviction, of up to \$50,000.



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