



**EXTERNAL REPORTING BOARD**

---

*Te Kāwai Ārahi Pūrongo Mōwaho*

## **Proposals for the New Zealand Accounting Standards Framework**

Incorporating the Draft Tier Strategy and Presented to the Minister  
of Commerce in accordance with Section 34A of the Financial  
Reporting Act 1993

March 2012

Approved by the Minister of Commerce in accordance with  
Section 34C of the Financial Reporting Act 1993  
on 2 April 2012

# Contents

	<i>Page</i>
List of Abbreviations	3
Executive Summary	5
<b>1. Introduction</b>	<b>7</b>
1.1 Purpose of this Document	7
1.2 Overview of Content	7
1.3 Historical Context	7
<b>2. Proposed Accounting Standards Framework</b>	<b>12</b>
2.1 Tier Structure	12
2.2 Tier Criteria	12
2.3 Accounting Standards	20
<b>3. Reasons for the Proposed Accounting Standards Framework</b>	<b>22</b>
3.1 Meeting User-Needs: The Multi-Standards Approach	22
3.2 Weighing Costs and Benefits: The Tier Approach	28
3.3 Accounting Standards that Reflect the Tier Rationale	31
3.4 Rationale for Specific Tier Criteria and Requirements	37
3.5 Consistency with Legislative Objective	41
<b>4. Consultation Undertaken</b>	<b>43</b>
4.1 Overview	43
4.2 ASRB Discussion Document	43
4.3 XRB Consultation Papers	46
4.4 Consultation Adequacy	50
<b>5. Implementation</b>	<b>51</b>
<b>Appendix 1 – Respondents to the 2009 Discussion Document</b>	<b>52</b>
<b>Appendix 2 – Respondents to the 2011 Consultation Papers</b>	<b>54</b>

## List of Abbreviations

The following abbreviations are used in this document.

AASB	Australian Accounting Standards Board
Accounting Standards Framework	The External Reporting Board's proposals for a new accounting standards framework for New Zealand
ASRB	Accounting Standards Review Board
Discussion Document	The 2009 ASRB Discussion Document on a proposals for a new Accounting Standards Framework
FMA	Financial Markets Authority
FRS	Financial Reporting Standards
GAAP	Generally Accepted Accounting Practice
GPFR	General Purpose Financial Reports
IASB	International Accounting Standards Board
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IFRS for SMEs	International Financial Reporting Standard for Small and Medium-Sized Entities
IPSAS	International Public Sector Accounting Standards
IPSASB	International Public Sector Accounting Standards Board
MED	Ministry of Economic Development
NFP	Not-for-profit
NZICA	New Zealand Institute of Chartered Accountants
NZ IFRS	New Zealand equivalents to International Financial Reporting Standards
NZ IFRS Diff Rep	New Zealand equivalents to International Financial Reporting Standards Framework with differential reporting recognition, measurement and disclosure concessions

NZ IFRS RDR	New Zealand equivalents to International Financial Reporting Standards with disclosure concessions in accordance with the New Zealand for-profit Reduced Disclosure Regime
Old GAAP	The suite of accounting standards (Financial Reporting Standards (FRSs) and Statements of Standard Accounting Practice (SSAPs)) that were applicable in New Zealand prior to the adoption of NZ IFRS in New Zealand.
PAS	PBE Accounting Standards
PAS RDR	PBE Accounting Standards Reduced Disclosure Regime
PBE	Public Benefit Entity
PSFR-A	PBE Simple Format Reporting Standard - Accrual
PSFR-C	PBE Simple Format Reporting Standard - Cash
RDR	Reduced Disclosure Regime
SSAP	Statement of Standard Accounting Practice
The Act	The Financial Reporting Act 1993
Tier Strategy	Proposals for establishing different tiers of financial reporting in respect of different classes of relevant reporting entities
XRB	External Reporting Board

## Executive Summary

This document presents the External Reporting Board's (XRB) proposals for a new accounting standards framework for New Zealand. This includes different tiers of financial reporting for different classes of reporting entities. It is submitted to the Minister of Commerce in accordance with the requirements of section 34A of the Financial Reporting Act 1993 for his approval in accordance with section 34C of the Act.

The proposed Accounting Standards Framework has been developed to apply to entities that are statutorily required to prepare financial reports in accordance with generally accepted accounting practice. Those requirements are expected to change when legislative changes are enacted. The proposals take this into account.

The XRB proposes that the new Accounting Standards Framework consist of a two-sector, four-tier structure with different accounting standards applying to each tier.

The two sectors are those relating to for-profit entities and public benefit entities (PBEs). The XRB proposes that the definitions in the existing accounting standards framework continue to be used to determine whether an entity is a for-profit entity or a PBE.

The proposed tiers, tier criteria and accounting standards are as follows:

### *For-Profit Entities*

- Tier 1: entities that are publicly accountable (as defined) plus for-profit public sector entities that are large (as defined) - apply New Zealand equivalents to International Financial Reporting Standards (NZ IFRS);
- Tier 2: entities that are not publicly accountable (as defined) and for-profit public sector entities that are not large (as defined), and which elect to be in Tier 2 – apply New Zealand equivalents to International Financial Reporting Standards Reduced Disclosure Regime (NZ IFRS RDR);
- Tier 3: entities that are not publicly accountable (as defined) and either (a) all of its owners are members of the entity's governing body, or (b) are not large (as defined) and which elect to be in Tier 3 – apply New Zealand equivalents to International Financial Reporting Standards with differential reporting concessions (NZ IFRS Diff Rep);
- Tier 4: entities that are not publicly accountable (as defined), are not required to file financial statements, and are not large (as defined) and which elect to be in Tier 4 – apply accounting standards that were applicable prior to the adoption of NZ IFRS in New Zealand (Old GAAP).

The proposed for-profit Tier 3 and Tier 4 will be transitional tiers which will be removed when the anticipated legislative changes come into force. Those legislative changes will remove the statutory requirement for most small and medium sized companies to prepare financial statements in accordance with generally accepted accounting practice.

### *Public Benefit Entities*

- Tier 1: entities that are publicly accountable (as defined) plus entities that are large (as defined) – apply PBE Accounting Standards (PAS);

- Tier 2: entities that are not publicly accountable (as defined) and entities that are not large (as defined) and which elect to be in Tier 2 – apply PBE Accounting Standards Reduced Disclosure Regime (PAS RDR);
- Tier 3: entities that are not publicly accountable (as defined) and which have expenses ≤\$2 million and which elect to be in Tier 3 – apply PBE Simple Format Reporting Standard - Accrual (PSFR-A);
- Tier 4: entities allowed by law to use cash accounting and which elect to be in Tier 4 – apply PBE Simple Format Reporting Standard - Cash (PSFR-C).

The proposed Accounting Standards Framework includes definitions for the various tier criteria outlined above. It also defines the accounting standards that comprise the suites of standards that apply to each tier.

The proposed Accounting Standards Framework has been developed using a “user-needs” approach. Having undertaken an extensive review of the options the XRB concluded that user-needs cannot be adequately addressed by a single set of accounting standards, and that a multi-standards approach that also uses tiers to match costs and benefits should be adopted. The proposed Accounting Standards Framework reflects this approach. It uses International Financial Reporting Standards as the starting point for profit-oriented entities that have a statutory requirement to prepare and provide financial reports, and International Public Sector Accounting Standards as the starting point for public benefit entities that have a statutory requirement to prepare and provide financial reports.

The proposed Accounting Standards Framework has been developed through an extensive development and consultation process that began in early 2009. That process included the issuing of discussion and consultation papers, together with general and targeted consultation. The XRB carefully considered the feedback received through that process, assessing it in the context of the user-needs, cost-benefit approach. Initial proposals were adjusted where appropriate as the Framework developed.

The XRB proposes that the new Accounting Standards Framework be implemented in a staged way by sector over a three year period. This will involve the for-profit aspects becoming effective from October 2012, the PBE aspects as they relate to public sector entities applying for years beginning on or after 1 July 2014, and the PBE aspects as they relate to not-for-profit entities applying for years beginning on or after 1 April 2015.

# 1. Introduction

## 1.1 Purpose of this Document

1. This document presents the External Reporting Board's (XRB) proposals for a new accounting standards framework for New Zealand (Accounting Standards Framework). The Accounting Standards Framework includes proposals for establishing different tiers of financial reporting in respect of different classes of relevant reporting entities (the Tier Strategy).
2. The Accounting Standards Framework (incorporating the Tier Strategy) has been prepared by the XRB in accordance with section 34A of the Financial Reporting Act 1993 (the Act). It is submitted to the Minister of Commerce in accordance with the requirements of that section for his approval in accordance with section 34C of the Act.

## 1.2 Overview of Content

3. The Accounting Standards Framework has been developed by the XRB through an extensive development and consultation process that began in early 2009. That process included the issuing of discussion and consultation papers, together with general and targeted consultation.
4. This document covers the following matters:
  - The proposed tiers;
  - The classes of entities within each tier, together with the criteria for determining those classes of entity;
  - The accounting standards that will apply to each tier;
  - The reasons for the proposed tiers, criteria and accounting standards; and
  - The nature and extent of consultation undertaken in developing the Accounting Standards Framework.
5. This content complies with the requirements of section 34B of the Act which specifies the minimum matters that must be covered in a tier strategy.

## 1.3 Historical Context

### *Institutional Arrangements*

6. Up until the early 1990s the responsibility for setting accounting standards in New Zealand rested solely with the New Zealand Society of Accountants (now the New Zealand Institute of Chartered Accountants - NZICA).
7. The enactment of the Financial Reporting Act 1993 resulted in the establishment of the Accounting Standards Review Board (ASRB). The ASRB had responsibility for approving, but not developing, accounting standards. Under the Act any person or organisation could develop a standard and submit it to the ASRB for approval. In

practice only NZICA did so. This meant that the standard setting process involved NZICA developing the accounting standards and then the ASRB approving them.

8. While this arrangement worked quite well one of the problems with it was that neither NZICA nor the ASRB had responsibility for considering the overall accounting standards strategy i.e. whether the overall structure of accounting standards, and the way in which they apply to reporting entities, was appropriate and reflected the relevant costs and benefits of preparing general purpose financial reports.
9. This difficulty was addressed in amendments to the Act enacted in 2011. Those amendments transformed the ASRB into the XRB and gave it responsibility for financial reporting strategy as well as setting accounting and auditing and assurance standards. This change in statutory function has allowed the XRB to consider whether the existing accounting standards framework is appropriate and what changes should be made.
10. The amendments to the Act envisaged that the XRB would undertake such a review. It established processes that the XRB must follow when developing a tier strategy as part of the accounting standards framework. These include the requirement to submit proposals to the Minister of Commerce for approval.
11. The Minister's review role is not a technical accounting one. Rather it is to ensure that the XRB has followed appropriate due process when developing its proposals, and has taken into account the relevant advantages and disadvantages.

#### *Existing Accounting Standards Framework*

12. Prior to 2004, New Zealand accounting standards were a set of domestically produced standards that were sector neutral (they applied to entities in the for-profit, public and not-for-profit sectors). The sector neutral approach was relatively unique internationally with only New Zealand and Australia having a single set of standards that applied to all reporting entities.
13. In 2002 the ASRB decided that New Zealand should adopt New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) in place of the domestic standards. This reflected the growing acceptance of International Financial Reporting Standards (IFRS) internationally and the decision of the European Union and Australia to adopt IFRS. The ASRB considered it necessary for New Zealand to also adopt IFRS to protect the credibility of New Zealand financial reporting. Although New Zealand was an early adopter of IFRS, the ASRB's decision has been validated by the fact that IFRS is now viewed internationally as the accepted basis for reporting by capital market entities.
14. Unlike the former domestic accounting standards, IFRS is not designed to be sector neutral. They are explicitly designed to meet the information needs of capital market users. However, given our sector neutral heritage, the ASRB decided (in 2002) that NZ IFRS should apply to all reporting entities. The Australian Accounting Standards Board (AASB) made a similar decision in relation to Australian reporting entities. Most other jurisdictions limited the compulsory



application of IFRS to for-profit entities, and usually just entities financed through the capital markets.

15. In recognition of the different user-needs of public sector and not-for-profit sector entities, NZICA and the ASRB adopted the profit-oriented-entity/public benefit entity (PBE) distinction as part of the development of NZ IFRS<sup>1</sup>. PBEs were defined as entities which have a social rather than for-profit objective<sup>2</sup> and additional PBE specific paragraphs were developed for inclusion in NZ IFRS.
16. The end result was a single set of IFRS-based standards, which applied to all entities from all sectors but which contained some variations for PBEs. A differential reporting version of those standards was also developed for use by “qualifying entities” (entities that were not issuers and not large).
17. In 2007 the ASRB decided that small entities which met certain conditions should be permitted to continue to use the domestic standards (which have come to be known as “Old GAAP”) instead of NZ IFRS. This was in recognition of the cost of adopting NZ IFRS and the ASRB’s understanding that the Government intended to review whether the entities using Old GAAP should continue to be required to prepare general purpose financial reports.
18. Although the “tier” language was not used at that time, the accounting standards framework established by NZICA and the ASRB effectively consisted of three tiers as follows:
  - Tier 1: NZ IFRS with PBE paragraphs: All reporting entities unless they are eligible to be in one of the other tiers;
  - Tier 2: NZ IFRS with PBE paragraphs with differential reporting: Reporting entities that meet the specified criteria<sup>3</sup> and elect to apply differential reporting; and
  - Tier 3: Old GAAP: Entities that meet the specified criteria<sup>4</sup> and elect to apply Old GAAP.<sup>5</sup>

---

<sup>1</sup> This distinction was initially developed by the United Kingdom standard setter.

<sup>2</sup> The full definition is: “A reporting entity whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders.”

<sup>3</sup> Those criteria are: the entity does not have public accountability (is not an issuer) and either (a) at the end of the reporting period, all of its owners are members of the entity’s governing body; or (b) the entity is not large (does not meet two of the following criteria: total income of \$20.0 million; total assets of \$10.0 million; or 50 employees).

<sup>4</sup> Those criteria are:

- If a company: (a) the company is not an issuer as defined by the Financial Reporting Act 1993, either in the current or preceding accounting period; (b) the company is not required by section 19 of the Financial Reporting Act 1993 to file its financial statements with the Registrar of Companies; and (c) the company is not large (does not meet two of the following criteria: total income of \$20.0 million; total assets of \$10.0 million; or 50 employees).
- If a non-company for-profit entity: (a) the entity has a statutory obligation to prepare financial statements; and (b) the entity does not have public accountability (is not an issuer) and is not large. (does not meet two of the following criteria: total income of \$20.0 million; total assets of \$10.0 million; or 50 employees).

19. This accounting standards framework, which was established in 2004, continues to apply.

#### *Need for a New Accounting Standards Framework*

20. When the decision to adopt IFRS was made, the development of IFRS by the International Accounting Standards Board (IASB) was still in its infancy. As a result the future focus and content of those standards was uncertain. In the intervening period the IASB has clarified that its focus is on developing accounting standards for application by for-profit entities, particularly those being financed through the capital markets. The information required to be reported under IFRS therefore reflects the needs of capital market users.
21. It has become increasingly clear that the capital markets focus of IFRS makes those standards less relevant to the users of non-capital market entities. There has been significant comment about this in New Zealand in recent years, particularly from the PBE sector.
22. Beginning in 2008 the ASRB considered the matter in detail and concluded that these were valid concerns that needed to be addressed in the New Zealand context. In September 2009 the ASRB issued a Discussion Document outlining some tentative proposals for a new accounting standards framework for general purpose financial reporting.
23. During 2010 the ASRB considered the feedback received on that Discussion Document in considerable detail. As part of this process the ASRB evaluated two broad accounting standards framework options: enhanced NZ IFRS equivalents (a continuation of the single standard approach); and a multi-standards approach (involving one set of standards for for-profit entities, and another set of accounting standards for PBEs).
24. The ASRB concluded that user-needs cannot be adequately addressed by a single set of accounting standards, and that a multi standards approach that also uses tiers to match costs and benefits should be adopted. This conclusion was considered and confirmed by the XRB when it came into existence on 1 July 2011.<sup>6</sup> Giving effect to this conclusion requires a new accounting standards framework to be established.
25. Another driver for the development of a new accounting standards framework has been the Government's decision to establish a new statutory financial reporting framework. The new statutory framework will, amongst other things, remove most small and medium sized for-profit entities from the requirement to report in accordance with generally accepted accounting practice (GAAP). On the other hand it will require registered charities to report using GAAP.<sup>7</sup> The changes to

---

<sup>5</sup> An effective fourth tier was created by the Act which established the exempt company regime. This allowed small companies (as defined by section 6A of the Act) to produce simplified, fill-in-the-box type reports in accordance with the Financial Reporting Order 1994.

<sup>6</sup> The rationale for adopting a multi-standards approach is considered in Section 3 of this document.

<sup>7</sup> Details of the new legislative financial reporting framework are available on the MED website: [www.med.govt.nz](http://www.med.govt.nz)

“who” has to report necessitate a change to the accounting standards framework so that the different nature and size of entities now required to report can be appropriately accommodated (in both the short and long term).

26. The proposed new Accounting Standards Framework that has been developed by the XRB to take account of these factors is specified in Section 2.

## 2. Proposed Accounting Standards Framework

### 2.1 Tier Structure

27. The XRB proposes that the new Accounting Standards Framework consist of a two-sector, four-tier structure with different accounting standards applying to each tier. The proposed tier structure is depicted in Table 1 and outlined below. The rationale for this proposed tier structure is outlined in Section 3.
28. The proposed for-profit Tier 3 and Tier 4 are designed to cater for small and medium companies (or other for-profit entities). Based on the Government's announced decisions about the new statutory financial reporting framework, the XRB expects that the majority of these small and medium entities will cease to be required to comply with GAAP once legislative amendments are enacted. The XRB proposes that for-profit Tiers 3 and 4 be removed at that time. The proposed structure that will apply after they have been removed is depicted in Table 2.
29. Compared to the current structure:
- The two sector, multi-standards approach is new;
  - For-profit Tiers 1, 3 and 4 reflect the status quo, and for-profit Tier 2 is new; and
  - All the PBE tiers and accounting standards requirements are new.

### 2.2 Tier Criteria

30. The XRB proposes that the criteria outlined below be used to specify the various tiers. The criteria include a number of definitions and it is intended that these definitions will be included in the relevant accounting standards. The XRB has consulted on the approach to be followed for each definition and the feedback indicated general agreement. However, it has yet to consult on the specific wording of each definition and it is possible that some of the definitions may be amended as a result of that consultation process.

#### *Sector Definitions*

31. The XRB proposes the definitions used in the past continue to be used to determine whether an entity falls within the for-profit or PBE accounting standards frameworks:

##### PBE

*"A reporting entity whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders".*

##### For-Profit Entity

*"Any reporting entity that is not a public benefit entity".*

**Table 1: Initial Accounting Standards Framework Tier Structure**

	For-Profit Entities		Public Benefit Entities	
	Entities	Accounting Standards	Entities	Accounting Standards
Tier 1	<ul style="list-style-type: none"> <li>Publicly accountable (as defined)</li> <li>Large (as defined) for-profit public sector entities</li> </ul>	NZ IFRS	<ul style="list-style-type: none"> <li>Publicly accountable (as defined)</li> <li>Large (as defined)</li> </ul>	PBE Accounting Standards (PAS)
Tier 2	<ul style="list-style-type: none"> <li>Non-publicly accountable</li> <li>Non-large for-profit public sector entities</li> </ul> <p>which elect to be in Tier 2.</p>	NZ IFRS Reduced Disclosure Regime (NZ IFRS RDR)	<p>Non-publicly accountable (as defined) and non-large (as defined)</p> <p>which elect to be in Tier 2.</p>	PBE Accounting Standards Reduced Disclosure Regime (PAS RDR)
Tier 3	<p>Non-publicly accountable and either all of its owners are members of the entity's governing body; or not large (as defined)</p> <p>which elect to be in Tier 3.*</p>	NZ IFRS Differential Reporting (NZ IFRS Diff Rep)*	<p>Non-publicly accountable (as defined) with expenses ≤\$2 million</p> <p>which elect to be in Tier 3.</p>	PBE Simple Format Reporting Standard - Accrual (PSFR-A)
Tier 4	<p>Non-publicly accountable, not required to file financial statements, and not large (as defined)</p> <p>which elect to be in Tier 4.*</p>	Old GAAP*	<p>Entities allowed by law to use cash accounting</p> <p>which elect to be in Tier 4.</p>	PBE Simple Format Reporting Standard - Cash (PSFR-C)

\* Transitional tier which will be removed when the legislative changes come into force.

**Table 2: Accounting Standards Framework Tier Structure After Legislative Changes Enacted**

	For-Profit Entities		Public Benefit Entities	
	Entities	Accounting Standards	Entities	Accounting Standards
Tier 1	<ul style="list-style-type: none"> <li>Publicly accountable (as defined)</li> <li>Large (as defined) for-profit public sector entities</li> </ul>	NZ IFRS	<ul style="list-style-type: none"> <li>Publicly accountable (as defined)</li> <li>Large (as defined)</li> </ul>	PBE Accounting Standards (PAS)
Tier 2	<ul style="list-style-type: none"> <li>Non-publicly accountable</li> <li>Non-large for-profit public sector entities</li> </ul> <p>which elect to be in Tier 2.</p>	NZ IFRS Reduced Disclosure Regime (NZ IFRS RDR)	<p>Non-publicly accountable (as defined) and non-large (as defined)</p> <p>which elect to be in Tier 2.</p>	PBE Accounting Standards Reduced Disclosure Regime (PAS RDR)
Tier 3			<p>Non-publicly accountable (as defined) with expenses ≤\$2 million</p> <p>which elect to be in Tier 3.</p>	PBE Simple Format Reporting Standard - Accrual (PSFR-A)
Tier 4			<p>Entities allowed by law to use cash accounting</p> <p>which elect to be in Tier 4.</p>	PBE Simple Format Reporting Standard - Cash (PSFR-C)

32. The XRB envisages some of the PBE Accounting Standards (PAS) requirements may only apply to public sector PBEs or only apply to not-for-profit (NFP) PBEs. It is therefore necessary to also define these two sectors. The XRB proposes that the following definitions be used:

Public Sector PBEs

*"A reporting entity that is a public entity as defined by the Public Audit Act 2001 and which is a PBE, and all Offices of Parliament."*

NFP PBEs

*"Any reporting entity that is a PBE and is not a public sector PBE".*

*For-Profit Tier Criteria*

Tier 1 Criteria

*Public Accountability*

33. The XRB proposes that public accountability be used as the primary criterion to establish the for-profit tiers, and in particular which entities should be required to report in accordance with Tier 1 requirements. The public accountability distinction has been used by the IASB in developing IFRS and is generally accepted internationally.

34. The XRB proposes the following definition be used:

*"An entity is publicly accountable if:*

- a. It meets the IASB definition of public accountability, namely:*

*An entity has public accountability if:*

- (a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or*
- (b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance providers, securities brokers/dealers, mutual funds and investment banks.*

*Some entities may also hold assets in a fiduciary capacity for a broad group of outsiders because they hold and manage financial resources entrusted to them by clients, customers or members not involved in the management of the entity. However, if they do so for reasons incidental to a primary business (as, for example, may be the case for travel or real estate agents, or cooperative enterprises requiring a nominal membership deposit), they are not considered to be publicly accountable; or*

- b. Is one of the following entity types that are deemed to be publicly accountable in the New Zealand context:*

- i. All issuers, as defined by the Securities Act 1978 (or any Act that replaces it) or any other Act (no matter what size);*

- ii. *Registered Banks, as defined by the Reserve Bank Act 1989;*
- iii. *Deposit Takers, as defined by the Reserve Bank Act 1989; and*
- iv. *Registered Superannuation Schemes, as defined by the Superannuation Schemes Act 1989*

*unless exempted by statute or regulation from the requirement to prepare general purpose financial reports in accordance with GAAP."*

- 35. The definition will be amended to reflect changes to legislation as they occur, most notably the anticipated enactment of the Financial Markets Conduct Bill 2011.
- 36. All publicly accountable entities will be required to report in accordance with Tier 1 requirements.

#### *Large For-Profit Public Sector Entities*

- 37. For-profit entities can be from any sector and so will include for-profit public sector entities, such as State-Owned Enterprises and for-profit Council Controlled Organisations. The XRB proposes that large for-profit public sector entities which are not publicly accountable (as defined) also be required to report in accordance with Tier 1 requirements.
- 38. The XRB proposes that for this purpose, large be defined as:

*"Entities with expenses greater than \$30 million",*

with expenses defined as:

*"Expenses recognised in the profit or loss section of the Statement of Profit or Loss and Other Comprehensive Income in accordance with NZ IFRS".*

#### Tier 2 Criteria

- 39. The XRB proposes that Tier 1 be the default tier for all for-profit reporting entities. However, entities that are not publicly accountable (as defined) or for-profit public sector entities that are not large (as defined) may elect to be in Tier 2. The XRB proposes that the following apply:

*"A for-profit entity may elect to be in Tier 2 when the entity:*

- (a) does not have public accountability (as defined); and*
- (b) is not a large for-profit public sector entity (as defined)",*

with the same definitions of public accountability and large as specified in paragraph 34 and paragraph 38 respectively applying.

- 40. This approach allows entities that do not meet these criteria to report in accordance with a less onerous set of accounting standards if they consider that this results in a better matching of the costs and benefits of their reporting.



### Tier 3 Criteria

41. Entities that meet the Tier 3 criteria will be able to elect to be in Tier 3. The XRB proposes that the following apply:

“A for-profit entity may elect to be in Tier 3 when the entity does not have public accountability and either:

- (a) at the end of the reporting period, all of its owners are members of the entity’s governing body; or
- (b) the entity is not large.”

42. It is proposed that for the purposes of this tier:

- The same definition of public accountability as specified in paragraph 34 above apply;
- Large be defined as:

“Exceeding any two of the following:

- (a) total income of \$20.0 million;
- (b) total assets of \$10.0 million; or
- (c) 50 employees”,

with total income being defined as:

“the annualised gross income based on the amount reported in the entity’s Statement of Comprehensive Income for the current period. Income includes both revenue and gains. Revenue arises in the course of the ordinary activities of an entity and includes, but is not limited to, sales, fee income, grants, output appropriations, cost recoveries, donations, dividends, interest, and subscriptions. Gains represent other items that meet the definition of income and may, or may not, arise in the course of the ordinary activities of an entity”,

and total assets being defined as:

“the value of assets (including intangible assets) reported in the entity’s Statement of Financial Position at the end of the current period”.

43. It is also proposed that:

“A for-profit public sector entity which does not have public accountability (as defined) but whose parent or ultimate controlling entity has the coercive power to tax, rate or levy to obtain public funds may only qualify for Tier 3 where that for-profit entity is not large (as defined)”.

44. These Tier 3 criteria are consistent with the existing criteria for applying NZ IFRS Diff Rep and so maintain the status quo.

#### Tier 4 Criteria

45. Entities that meet the Tier 4 criteria will be able to elect to be in Tier 4. The XRB proposes that the following apply:

“A for-profit company may elect to be in Tier 4 when it:

- (a) does not have public accountability; and
- (b) is not large; and
- (c) is not required by section 19 of the Financial Reporting Act 1993 to file its financial statements with the Registrar of Companies; and
- (d) was applying Old GAAP at 30 June 2011, or was established on or after 1 July 2011.

A for-profit entity other than a company may elect to be in Tier 4 if it:

- (a) does not have public accountability; and
- (b) is not large; and
- (c) was applying Old GAAP before 30 June 2011, or was established on or after 1 July 2011.”

46. It is proposed that for the purposes of this tier:

- The same definition of public accountability as specified in paragraph 34 above apply;
- Large be defined as:

“Exceeding any two of the following:

- (a) total revenue of \$20.0 million;
- (b) total assets of \$10.0 million; or
- (c) 50 employees”,

with revenue being defined as:

“the annualised gross operating revenue based on the amount reported in the entity’s Statement of Financial Performance for the current reporting period. Total revenue includes, but is not limited to, sales, fee income, grants, output appropriations, cost recoveries, donations, dividends, interest and subscriptions”,

and assets being defined as:

“the value of assets (including intangible assets) reported in the entity’s Statement of Financial Position at the end of the current period”.

47. These Tier 4 criteria are consistent with the existing criteria for applying Old GAAP and so maintain the status quo.

## *PBE Tier Criteria*

### Tier 1 Criteria

#### *Entity Size*

48. The XRB proposes that entity size be used as the primary criterion to establish the PBE tiers and that all large PBEs be required to report in accordance with Tier 1 requirements. For this purpose, large will be defined as:

*"Entities with expenses greater than \$30 million",*

with expenses defined as:

*"Expenses recognised in the Statement of Financial Performance in accordance with PAS".*

#### *Public Accountability*

49. The XRB proposes that PBEs which have public accountability also be required to report in accordance with Tier 1 requirements. This is consistent with the higher level of accountability expected of entities operating in the capital markets.
50. It is proposed that the same definition of public accountability as specified in paragraph 34 above apply (to ensure consistency across the whole Accounting Standards Framework). It is acknowledged that this is a narrower definition of public accountability than is used in general parlance and in the Government's framework to determine whether an entity should comply with GAAP. However, it is consistent with that used in the for-profit framework.

### Tier 2 Criteria

51. The XRB proposes that, as with the for-profit framework, Tier 1 be the default tier for all public benefit entities. However, entities that are not large (as defined) and not publicly accountable (as defined) may elect to be in another tier if they meet the criteria for that tier.
52. The XRB proposes that the criteria for Tier 2 be as follows:

*"A PBE may elect to be in Tier 2 when the entity:*

*(a) does not have public accountability (as defined); and*

*(b) is not a large PBE (as defined)."*

with the same definitions of public accountability and large as specified in paragraph 34 and paragraph 48 respectively applying.

53. This approach allows entities that do not meet these criteria, to report in accordance with a simpler set of accounting standards if they consider it results in a better matching of the costs and benefits of their reporting. It is expected that the majority of entities eligible to do so will make the election.

### Tier 3 Criteria

54. The XRB proposes that the criteria for Tier 3 be as follows:

*"A PBE may elect to be in Tier 3 when the entity:*

*(a) does not have public accountability (as defined); and*

*(b) has expenses (as defined) less than or equal to \$2 million",*

with expenses defined as:

*"Expenses recognised in the Statement of Financial Performance in accordance with PAS".*

### Tier 4 Criteria

55. The XRB proposes that the criterion for Tier 4 be as follows:

*"A PBE may elect to be in Tier 4 when the law allows the entity to report in accordance with cash accounting".*

56. This criterion caters for those entities which, under the Government's framework, will be required to prepare general purpose financial reports but may do so using cash accounting rather than GAAP. This tier definition is proposed on the understanding that the criteria for entities able to report on a cash accounting basis will be specified in statute.

## **2.3 Accounting Standards**

57. The XRB proposes that the accounting standards applying to the for-profit tiers be as follows:

- For-Profit Tier 1: NZ IFRS converged with IFRS, supplemented by additional New Zealand specific standards as necessary, and harmonised with Australia as appropriate. This is an existing suite of standards that will be amended from time to time in accordance with the XRB's power to issue and amend standards.
- For-Profit Tier 2: NZ IFRS RDR comprising the standards applying to Tier 1 but with reduced disclosure concessions harmonised with Australia as appropriate. This is a new suite of standards that will be issued and amended from time to time in accordance with the XRB's power to issue and amend standards.
- For-Profit Tier 3: NZ IFRS Diff Rep comprising the standards applying to Tier 1 but with differential reporting concessions, including recognition and measurement concessions. This is an existing suite of standards that will be unchanged after 1 March 2012. This suite of standards will be revoked when the legislative changes come into force.
- For-Profit Tier 4: Old GAAP comprising FRSs and SSAPs, including differential reporting concessions. This is an existing suite of standards that has been unchanged since 2002 and which will continue to be

unchanged. This suite of standards will be revoked when the legislative changes come into force.

58. The XRB proposes that the accounting standards applying to the PBE tiers be as follows:

- PBE Tier 1: PBE Accounting Standards (PAS) comprising International Public Sector Accounting Standards (IPSAS), modified as appropriate for New Zealand circumstances, together with additional standards as necessary. This is a new suite of standards which will be issued and amended from time to time in accordance with the XRB's power to issue and amend standards.
- PBE Tier 2: PAS RDR comprising the standards applying to Tier 1 but with reduced disclosure concessions. This is a new suite of standards which will be issued and amended from time to time in accordance with the XRB's power to issue and amend standards.
- PBE Tier 3: PBE Simple Format Reporting Standard – Accrual (PSFR-A) comprising a single standard allowing reporting in accordance with a simple format approach, using accrual accounting but with recognition and measurement concessions (compared to Tiers 1 and 2). This is a new suite of standards which will be issued and amended from time to time in accordance with the XRB's power to issue and amend standards.
- PBE Tier 4: PBE Simple Format Reporting Standard – Cash (PSFR-C) comprising a single standard allowing reporting in accordance with a simple format approach, using cash accounting. This is a new suite of standards which will be issued and amended from time to time in accordance with the XRB's power to issue and amend standards.

### 3. Reasons for the Proposed Accounting Standards Framework

59. This Section outlines the XRB’s rationale for the proposed new Accounting Standards Framework specified in Section 2.

#### 3.1 Meeting User-Needs: The Multi-Standards Approach

##### *A User-Needs Approach*

60. The Government’s financial reporting framework establishes a primary purpose for general purpose financial reporting: to provide information to external users who would otherwise be unable to obtain that information. The “Primary Principle” and related “Indicators” as specified in the Government’s framework are summarised in Table 3.

**Table 3: Primary Principle and Indicators<sup>8</sup>**

<p style="text-align: center;"><b><u>Primary Principle</u></b></p> <p>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 demand them.</p> <p style="text-align: center;"><b><u>Indicators that an Entity meets the Primary Principle</u></b></p> <p><b>Public Accountability:</b> when an entity receives money directly from the public which is then reliant on GPFR to assess how well that money is being used or managed. This arises in the case of issuers of securities who invite the public to invest directly; public sector accountability for public money to taxpayers and ratepayers; and not-for-profit entities which receive donations from the public.</p> <p><b>Economic Significance:</b> where there is likely to be a significant economic or social impact on the national or regional economy if the entity fails and where stakeholders are reliant on GPFR to assess the financial position and performance of the entity.</p> <p><b>Separation of Ownership and Management:</b> where there is a degree of separation of owners from management and the owners are therefore reliant on GPFR to assess the performance, financial position and cash flows of the entity.</p>
---

61. The XRB has used this Primary Principle as the starting point for the development of the tier structure proposals. In order to meet this Principle the Accounting Standards Framework must be focused on providing (financial and non-financial) information to meet the needs of users of general purpose financial reports. Put another way, the substantive test of whether or not accounting standards are “fit-for-purpose” is whether they meet this user-needs test.
62. Different users have different information needs and it is important that these needs be reflected appropriately in reporting requirements. However, identifying users and their information needs is a difficult proposition. In practice simplifying

<sup>8</sup> Statutory Framework for Financial Reporting, Ministry of Economic Development, paragraphs 45 – 53.

assumptions are required and a sectoral distinction is the most common method used internationally to do this.

63. While sectors can be dichotomised in numerous ways to reflect different users and their information needs, the XRB's view is that the distinction currently used in New Zealand between for-profit and public benefit entity sectors is the most useful basis for doing so. While it would be possible to divide entities into more than two sectors, this would significantly increase the degree of fragmentation (and therefore cost) in the overall Accounting Standards Framework. The XRB's view is therefore that a two sector distinction is the most cost-effective because it caters for the two broad groups of financial statement users – those interested primarily in return on investment (for-profit entities); and those interested primarily in community or social benefit (PBEs).
64. However, the XRB recognises that in establishing the framework or developing specific standards there may be occasions when it is useful to consider sub-sectors (such as private not-for-profit entities within the PBE sector) or groups with particular characteristics. The XRB considers the public sector/not-for-profit sector distinction within the PBE sector to be particularly useful as the users and their needs are not always the same.
65. Users in different sectors and with different primary interests are likely to have a combination of similar and differing information needs. Users with common interests, like those concerned with economic significance, are likely to be interested in broadly the same information regardless of the sector the entity falls within. On the other hand there can be quite different user-needs between sectors. For example, service performance information will generally be important to PBE sector users but of less interest to for-profit users.
66. Significant differences can even occur within sectors. For example, in the not-for-profit sector donors are likely to be interested in the fundraising costs of charities and whether donations were used for the purposes intended. In member-based entities users will have a greater interest in things like the level of current and future members' fees, the services provided with those fees, the efficiency with which those services are produced, and the financial position of the entity.
67. The XRB's view is that these differing sector user-needs should inform accounting standard requirements at both the broad and specific level. At the broad level they should be used to determine the general focus and appropriateness of a set of standards. Specific standards should then address the particular information needs of the various users.

### *Meeting User-Needs*

68. Under the existing accounting standards framework, all reporting entities (other than those allowed to use Old GAAP) are required to comply with NZ IFRS (or a differential reporting version of it) – the single standard approach. In recent years there has been growing unease about this requirement, particularly from the PBE sector.

69. The reason for this is that when the IASB is developing IFRS it has capital market users in mind. As a result there is a general consensus that NZ IFRS is not well suited to deal with the information needs of non-capital market users, especially those in the PBE sector.
70. In a report to Parliament the then Auditor General outlined his concerns about the suitability of IFRS to public sector reporting: "... continuing to apply NZ IFRS is not in the long-term best interests of the majority of entities in the public sector".<sup>9</sup>
71. A similar view was expressed by the then NZICA Not-for Profit Sector Advisory Committee: "*The Committee does not consider existing NZ IFRS adequately addresses the needs of users of not-for-profit entities, as the international standards from which our standards are developed are issued solely for profit-oriented entities and primarily with the securities markets in mind*".<sup>10</sup>
72. There was common agreement amongst the respondents to the ASRB's 2009 Discussion Document that the current accounting standards framework does not adequately address the diversity of user information needs. The XRB shares this view.
73. This being the case, the issue is how best to reflect user-need differences in the accounting standards. One respondent to the ASRB's 2009 Discussion Document succinctly summarised the options available as follows:

*"In the absence of a sector-neutral approach internationally, and assuming it is not efficient for New Zealand to develop separately its own set of accounting standards for cost/benefit reasons, ... there are two simple choices for developing New Zealand accounting standards for all sectors ... :*

- *Continue to use the existing NZ IFRSs as the single set of accounting standards, making further modifications or introducing supplementary New Zealand standards to better meet the needs of users in all sectors; or*
- *Adopt a separate suite of standards designed for application in specific sectors (i.e. continuing with IFRS for the profit-sector and switching to IPSAS for the public sector and as a starting point for the not-for-profit private sector)."*

74. The ASRB undertook an extensive consideration of these two options. Its deliberations were focused around the viability and net cost-benefit of each of these options. The ASRB concluded that the ability of the single standard option to adequately meet user-needs across all sectors is limited. The XRB agreed that accounting standards other than IFRS should be considered for application by PBEs as a better means to meet user-needs. The XRB considers that there is a limit to the extent to which NZ equivalents using an IFRS base can be adapted for PBEs.

---

<sup>9</sup> The Auditor General's Views on Setting Financial Reporting Standards for the Public Sector, Office of the Auditor General, June 2009, paragraph 5.6.

<sup>10</sup> Not-for-Profit Sector Advisory Committee Position Paper: New Zealand's Financial Reporting Standards Setting for Not-for-Profit Entities; New Zealand Institute of Chartered Accountants, May 2009; page 3.



75. In the XRB's view, the IASB and the IPSASB (the two international standard setters) focus on different user-needs, although there is some overlap. This is evident from their respective conceptual frameworks (acknowledging that the IPSASB Framework is still in development and the IASB is revising its Framework):
- The IASB Conceptual Framework for Financial Reporting 2010 (IASB Conceptual Framework) identifies the primary users of general purpose financial reports as existing and potential investors, lenders and other creditors that cannot require reporting entities to provide information directly to them.<sup>11</sup>
  - The draft IPSASB Conceptual Framework states that the primary users of GPFR are service recipients and their representatives and resource providers and their representatives.<sup>12</sup>
76. The identification of "resource providers" as primary users in the IPSASB Framework is similar, although not identical to the users identified in the IASB Conceptual Framework. Governments and other public sector entities raise resources from taxpayers and donors, as well as lenders and creditors. The scope of resource providers is therefore much wider than the users identified by the IASB, although similar in concept.
77. The most significant difference comes with the IPSASB reference to "service recipients". This acknowledges that the reason that public sector entities raise resources is to provide services (both to the main resource providers – taxpayers and ratepayers - and to other members of the community). Accordingly these entities are accountable not only to resource providers for the management and use of those resources, but also those that receive, or expect to receive, the services funded by those resources. Service recipients are an additional and completely different user group, from the users identified in the IASB Framework.
78. The different user focus results in different information needs: IPSASB is concerned with reporting future service potential as well as future economic benefits/cash flows; IASB is interested primarily in the latter.
79. The XRB considers that the different user-focus will almost certainly lead to an increasing divergence over time between IFRS and IPSAS. Further, the differing conceptual foundation will almost certainly make IPSAS a more relevant base for PBE reporting, increasingly so over time. The different emerging conceptual bases will also likely increase the number of different reporting requirements. Incorporating these differences into a single set of standards would be cumbersome and probably confusing to many preparers and users.
80. Taking all of this into account the XRB's conclusion is that:
- IFRS is increasingly unsuitable as a base for PBE reporting; and

---

<sup>11</sup> The IASB's Conceptual Framework papers are available at:  
<http://www.ifrs.org/Current+Projects/IASB+Projects/Conceptual+Framework/Conceptual+Framework.htm>

<sup>12</sup> The IPSASB's Conceptual Framework papers are available at:  
<http://www.ifac.org/PublicSector/ProjectHistory.php?ProjID=0066>

- user-needs can be better addressed by adopting separate sets of standards – one for for-profit entities based on IFRS; and one for public benefit entities based on IPSAS.
81. In reaching this conclusion the XRB recognises that to date IPSAS is to a significant extent a public sector translation of IFRS with the substantive differences being relatively few – although where there are such differences they are usually important in terms of improving the quality of reporting from a user-needs perspective. Given the relatively small (albeit important) number of differences, the XRB’s conclusion is based on IPSAS’ potential to better meet user-needs in the future rather than its current status.
82. The XRB also recognises that adopting a two-set, multi-standards approach is not a panacea that will automatically address all the current concerns about PBE reporting. There are a number of areas not covered under IPSAS (the most critical of which is the reporting of service performance) just as there is with IFRS. It will take some time for these gaps to be filled – either by the IPSASB or, if necessary, domestically. It is important to have realistic expectations in this regard.

#### *Advantages and Disadvantages*

83. The primary advantage of adopting a multi-standards approach is a better meeting of user-needs as outlined above. This is not only in relation to public sector PBEs but also not-for-profit entities.
84. There are no specific international standards for not-for-profit entities and it would be uneconomic for New Zealand to develop a set of NFP standards from scratch. The most viable alternative at this time is to adopt or modify either IFRS or IPSAS for this purpose.
85. Although IPSAS is focused on public sector entities rather than not-for-profit PBEs, the XRB considers that the developing conceptual framework, particularly the additional focus on future service potential, is more relevant to not-for-profit PBEs than is IFRS. However, some limited adaptation as well as the use of not-for-profit language and examples are desirable for adoption in that sector. The XRB view is that a useful and cost effective approach to achieve this is to embed not-for-profit language, examples and additional requirements within the suite of PAS rather than as a separate set of not-for-profit standards.
86. The major disadvantage of the multi-standards approach is the resulting increase in fragmentation, particularly the need for greater sector specialisation within the accounting profession and potentially more complex professional education requirements.
87. The XRB considers that fragmentation should be minimised to the extent possible. While the multi-standards approach is designed to allow different user-needs to be reflected, as much transaction neutrality as possible should be retained and unnecessary differences between the two sets of standards minimised.

88. However, the greatest weight needs to be given to meeting user-needs and this should be the primary driver. While recognising the fragmentation implications, the XRB does not consider them to be of a magnitude that outweighs the benefit of better meeting user-needs. The fragmentation impact therefore does not, of itself, provide a sufficient reason not to adopt a multi-standards framework.
89. Further, work undertaken by the XRB has identified that there is currently a high degree of alignment between IFRS and IPSAS but that the standards are likely to diverge in the future as the respective conceptual frameworks are finalised and standards evolve. This means that greater differences in the reporting requirements for PBEs and for-profit entities are likely to evolve in the future regardless of the form of the standards. Increasing fragmentation in some form or other is therefore likely to be inevitable.
90. A second factor to consider is the impact on harmonisation with Australia. There is already a difference in the PBE reporting requirements between New Zealand and Australia. The adoption of a multi-standards approach will widen the difference, as Australia is, at present, planning to retain a single set of standards based on IFRS.
91. Although adopting a multi-standards framework would have New Zealand and Australia out of step for a time, it would have no implications for the achievement of the Government's trans-Tasman outcomes goals. Harmonisation of for-profit standards would be unaffected and harmonisation of public sector accounting standards is not part of the outcome goals. The goal relating to private not-for-profit entities is intended only to apply to entities operating in both jurisdictions.<sup>13</sup> The XRB is not aware of any public sector PBE or any not-for-profit entity with reporting obligations in both New Zealand and Australia.
92. This being the case there is limited benefit for PBE reporting entities from harmonisation at this time, except perhaps to allow comparability at the whole of government level. This benefit is small compared to the greater benefit of adopting a framework that better meets user-needs. The XRB's view is that the lack of trans-Tasman harmonisation for the PBE sector is not an impediment to adopting a multi-standards approach.
93. A third issue is the cost of making an accounting standards change. Any change involves a cost – to users in learning the new basis on which financial statements have been prepared; to preparers in implementing those new standards; to auditors in auditing against those standards; and to standard setters in developing the new standards.
94. The XRB has done an extensive analysis of the extent of change required to move from NZ IFRS to PAS. As identified above, at this point in time there is a high degree of alignment between the two suites of standards. The cost of adopting PAS is therefore relatively small, and is anticipated to be very small compared to the cost of adopting NZ IFRS in 2005 to 2007. The XRB considers that this cost is heavily outweighed by the potential improvement in meeting user-needs. Further

---

<sup>13</sup> The XRB understands this outcome goal is also under review.

the degree of current alignment and the likely future divergence means that the cost of the change is likely to be lower now than in the future.

### 3.2 Weighing Costs and Benefits: The Tier Approach

#### *Cost-Benefit Approach*

95. The second fundamental element of the Government's financial reporting framework is that the financial reporting system should weigh the benefits of financial reporting against the associated compliance costs. A multi-standards approach focuses on user-needs but it doesn't fully address cost-benefit issues. The XRB therefore considers that a further element (tiers) should be included in the new Accounting Standards Framework to explicitly address this issue.
96. Costs and benefits can differ depending on the perspective brought to bear:
- From a preparation perspective, the benefits of the information provided should outweigh the costs of collecting and reporting that information;
  - From an audit perspective, the benefits of assurance should outweigh the costs of providing that assurance; and
  - From a standard setting perspective, the benefits of developing standards should outweigh the costs of doing so.
97. It is often quite difficult to establish costs and (particularly) benefits for standards setting purposes. A broad approach to identifying benefits is therefore required, as summarised by the IASB:
- "In assessing whether the benefits of a proposed standard are likely to justify the costs it imposes, standard-setters generally consider the practicability of implementing it and whether some degree of precision might be sacrificed for greater simplicity and lower cost, in addition to other factors. Standard-setters' assessment of whether benefits of providing information justify the related costs usually will be more qualitative than quantitative. Even qualitative information that standard-setters can obtain about benefits, in particular, and costs often will be incomplete."*<sup>14</sup>
98. The main benefits of general purpose financial reports flow from the ability of users to use information in those reports to make economic decisions and assess accountability.
99. The main costs of general purpose financial reporting flow from the specific accounting standard measurement, recognition and disclosure requirements. In general, the more complex and sophisticated these requirements, the greater the costs of compliance.
100. Another factor that needs to be considered when considering costs and benefits is the importance of recognising the global environment in which many New Zealand entities now operate. Comparability of financial information with that produced in

---

<sup>14</sup> Discussion Paper: Preliminary Views on an Improved Conceptual Framework: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information; IASB 2006.

other jurisdictions (particularly in Australia) can be important in raising capital and to overall international competitiveness. The minimisation of financial reporting compliance costs for entities with operations in different jurisdictions is similarly important to those entities. New Zealand financial reporting requirements need to recognise these factors. One cost-effective way of doing so is to take account of the availability of credible international standards. Using international standards also strengthens international linkages for New Zealand's accounting profession, and reduces domestic standard setting costs.

### *Use of Tiers*

101. Given the difficulties involved, the cost-benefit concept needs to be operationalised at the application level.
102. It is reasonable to conclude that, given the variety of both users and the information they require, the value of information to different users will vary. In order to appropriately address costs and benefits, the Accounting Standards Framework needs to recognise this variability. The most common way of doing this is through a system of differential reporting whereby reporting requirements are reduced for different groups of entities in a manner commensurate with the reduction in benefit accruing to users from the information.
103. The XRB proposes that this approach be followed in the new Accounting Standards Framework and that it be given effect through the establishment of tiers. The use of tiers is a cost-effective way of recognising the cost-benefit principle while also helping to ensure consistency across the framework.

### *Tiers and Criteria – General Approach*

104. The exact number of tiers that should operate is a matter for judgement based on the range of cost-benefit variability. The XRB considers that the number of tiers should be established on a sector-by-sector basis and in a way that reflects the cost-benefit considerations in each sector. The XRB's proposal is that initially four tiers be established for each sector but that in the for-profit sector this reduces to two over time (see paragraph 110).
105. In terms of the criteria to be used to differentiate the tiers, the XRB proposes that two criteria are used:
  - Whether the entity has "public accountability" (i.e. operates in the capital markets or holds assets in a fiduciary capacity); and
  - Entity size.
106. The public accountability criterion (whether the entity operates in the capital markets or holds assets in a fiduciary capacity) is relevant to both for-profit and PBE sectors. The XRB considers that where this occurs the entity should be held to the highest level of accountability and should therefore be in the top tier.
107. Entity size is useful as a more general cost-benefit proxy. This is because the smaller the entity the smaller the likely number of users, and therefore the fewer

the benefits that are likely to accrue from general purpose financial reporting. On the other hand, the smaller the entity the greater will be the cost of preparing financial statements that comply with all the requirements of the full accounting standards (as a proportion of total entity costs). In order to match costs and benefits appropriately a reduction in reporting requirements is therefore generally appropriate for smaller entities.

108. Entity size is particularly useful in the PBE context where there are entities (that do not meet the public accountability test as defined in this document) which are hugely variable in terms of size. The XRB proposes to use the size criterion in that sector with three tiers needed to reflect the size variability. A fourth tier is required to cater for those entities that will be required to prepare general purpose financial reports but which can do so on a cash accounting basis.
109. Entity size is less useful in the for-profit sector because only entities that meet the government's public accountability test or which are large or meet the manager/owner separation test will be required to comply with GAAP once the legislative changes are enacted. The for-profit sector tier structure is therefore driven more by the capital market vs. non-capital market entity distinction than it is by size. Accordingly only two for-profit tiers are required over the long-term: one for capital market entities; and one for other entities.
110. It is proposed that two additional for-profit tiers be maintained in the interim. These are to cater for the small and medium sized for-profit entities that are currently required to comply with GAAP but which will not be required to do so once the changes to the legislation are enacted. These for-profit tiers three and four maintain the status quo in the interim.
111. The XRB considers that this final tier structure (two for-profit tiers and four PBE tiers) using the two criteria (public accountability and entity size) provides an appropriate matching of costs and benefits. It reflects the nature and size of entities that will be required to prepare general purpose financial reports in each sector.

#### *Tiers and Criteria – Other Options*

112. The XRB considered whether a range of additional criteria should be used to define the tiers. Three specific options considered were:
  - Levying of coercive revenue (taxes or rates);
  - Particular entity types (e.g. schools or gaming societies or types of charities); and
  - Economic significance.
113. In each case the XRB determined that there was no particular user-information requirement that justified an addition to the public accountability and size tier criteria. Adopting such criteria would, in the XRB's view, impose unnecessary additional cost on those entities.

### *Tiers and Criteria – Small Entities*

114. The XRB's tier criteria proposals mean that the "public accountability" criterion overrides the size criterion in that entities which meet the public accountability criterion will be required to report in accordance with Tier 1 requirements regardless of their size. It is possible, therefore, that some small entities that have public accountability will find themselves having to report in accordance with Tier 1 requirements e.g. small issuers, or small superannuation schemes.
115. The XRB's view is that the highest level of reporting should be required of entities that meet the "public accountability" criterion, regardless of their size. It is Parliament, not the XRB, which decides through legislation whether an entity has public accountability or not i.e. whether it is an issuer or an entity that holds assets in a fiduciary capacity. It is not the place of the XRB as the standard-setter to determine otherwise.
116. The financial reporting obligations of small issuers are, however, an important cost-benefit issue. The XRB considers that an appropriate mechanism to deal with any excessive reporting costs that may be faced by small entities with public accountability (in both for-profit and PBE sectors) needs to be established. The XRB is having discussions with the Financial Markets Authority and the Ministry of Economic Development with a view to identifying appropriate statutory mechanisms to provide appropriate relief for small issuers.

### *Advantages and Disadvantages*

117. The XRB sees significant advantages in adopting a tier approach and few disadvantages. The advantages relate to establishing an appropriate matching of the benefits and costs of reporting. The main disadvantage is a risk that the reporting requirements for lower tiers may not generate sufficient information to meet minimum user-needs. This risk can be managed by the standard-setter being cognisant of the risk and monitoring over time the usefulness of information required to be reported by accounting standards.

## **3.3 Accounting Standards that Reflect the Tier Rationale**

118. The third element of the Accounting Standards Framework is the specific accounting standards to be applied. These requirements need to reflect the multi-standards and tier approach and the rationale for that approach.

### *Accounting Standards for For-Profit Entities*

#### Tier 1: NZ IFRS

119. In December 2002 the ASRB announced that it had decided that New Zealand entities would be required to apply IFRS for periods beginning on or after 1 January 2007 (with early application permitted from 1 January 2005). The ASRB's decision reflected the then growing international demand for a common set of international standards and the decision at that time of key trading partners, most notably the European Union and Australia, to adopt IFRS. The ASRB's view then

was that it was important for international competitiveness for New Zealand reporting entities to be able to assert compliance with the international standards.

120. The XRB continues to hold this view. In the period since New Zealand decided to adopt IFRS, international acceptance of the standards has grown rapidly. IFRS is now the common basis for reporting by entities involved in most international capital markets.<sup>15</sup> Under the new for-profit tier structure these entities will be required to report in accordance with Tier 1 requirements.
121. The XRB's view is that continuing to require Tier 1 entities to apply IFRS is in New Zealand's best economic interests, even after taking into account any imperfections that individual standards might contain. While no set of standards is ever perfect, the XRB's view is that the overall quality of IFRS is good and results in meaningful and relevant general purpose financial reporting by for-profit entities, especially those operating in the global financial markets.
122. Establishing a single set of accounting standards to be applied across a large number of jurisdictions with a wide variety of regulatory arrangements is no easy task. Inevitably there will be aspects that will apply better in some jurisdictions than in others. In order for New Zealand reporting entities to be able to assert compliance with IFRS, and therefore for entities to gain the international credibility benefits and for users to gain the comparability benefits, IFRS as issued by the IASB has to be applied. Compliance cannot be asserted if standards have been modified in a local jurisdiction (in contrast to being added to which is permitted). This means that adoption of IFRS is essentially an "all or nothing" proposition.
123. In 2011 the standard setters in New Zealand and Australia completed a joint project to develop a harmonised set of IFRS equivalents. This resulted in harmonising amendments to NZ IFRS and a new domestic standard, FRS-44 *New Zealand Additional Disclosures*.
124. The harmonising amendments have led to substantive convergence of IFRS-equivalent accounting standards for for-profit entities in New Zealand and Australia. As such they provide a common set of standards for reporting on both sides of the Tasman. The amendments also resulted in NZ IFRS becoming substantively identical to (pure) IFRS<sup>16</sup>. This approach results in the effective adoption of (pure) IFRS.
125. The XRB characterises this approach as NZ IFRS converged with IFRS, supplemented by additional NZ specific standards, and harmonised as appropriate with Australia. Such an approach allows entities to assert compliance with IFRS while still providing a vehicle for addressing New Zealand specific issues.
126. The XRB considers the status quo to be appropriate for Tier 1 entities and accordingly proposes that the current suite of NZ IFRS (converged with IFRS,

---

<sup>15</sup> The United States is currently considering its position in relation to IFRS and a decision is expected sometime in 2012.

<sup>16</sup> This alignment with pure IFRS has been achieved through the promulgation of FRS-44 *New Zealand Additional Disclosures* which contains the majority of the New Zealand specific additional disclosures, together with other additional standards (such as FRS-42 *Prospective Financial Statements* and FRS-43 *Summary Financial Statements*) that address areas not covered by IFRS.



supplemented by additional New Zealand specific standards, and harmonised with Australia as appropriate) continue to apply to that tier under the new framework.

#### Tier 2: NZ IFRS RDR

127. In accordance with the tier approach, the objective of Tier 2 is to have a set of accounting standards requirements that results in a reduced preparation cost to reflect a reduced user-benefit. As outlined in paragraph 102 this requires some form of differential reporting and the XRB considered three options:
- International Financial Reporting Standard for Small and Medium-Sized Entities (IFRS for SMEs);
  - A domestic differential reporting framework with recognition, measurement and disclosure concessions; and
  - A Reduced Disclosure Regime with disclosure concessions only harmonised with Australia.
128. IFRS for SMEs has been specifically developed by the IASB as a version of IFRS for entities that are not publicly accountable (under the IASB definition). The use of the IASB distinction as criterion for the for-profit tiers means that there is a direct relationship between the Tier 2 entities and the IASB standard created for their use (IFRS for SMEs). The adoption of IFRS for SMEs would therefore allow these entities to assert compliance with appropriate internationally set standards. Further there are significant cost-benefit advantages (from a standard setting perspective) in using an international standard.
129. However, while there has been significant uptake of IFRS for SMEs internationally (frequently with changes by jurisdictions adopting the standard), there continue to be mixed views about its usefulness as a differential version of IFRS. The major concern is the recognition and measurement concessions that it contains. This can result in a different “picture” about the financial performance and position of an organisation depending on whether the entity is applying IFRS or IFRS for SMEs. The XRB considers this undesirable and unhelpful to users of the entities which would in future be able to elect to be in Tier 2, particularly users who are investing across a number of entities. The different recognition and measurement approaches also make it more costly for groups that have subsidiaries in both Tiers 1 and 2 and therefore use a different basis for reporting. The Australian standard setter reached similar conclusions.
130. New Zealand has had a domestic differential reporting framework, designed for small and medium sized entities, in place for around twenty years. The second option considered by the XRB (a domestic differential reporting framework) would be similar to this existing differential reporting framework in that it would contain a limited number of recognition and measurement exemptions as well as disclosure concessions. However, the existing differential reporting framework would need to be revised to reflect the different composition of entities that are likely to meet the Tier 2 criteria (mostly large entities), compared to the current differential reporting framework criteria (small and medium entities). The revised

differential reporting framework would most likely require a cash flow statement to be presented and deferred taxation to be calculated and reported for example.

131. A revised domestic differential reporting framework would be relatively expensive to establish and maintain as it would be a purely domestic standard. Further, as the AASB has decided not to allow recognition and measurement concessions for its Tier 2 entities, it would not result in a harmonised set of requirements.
132. The third option is a Reduced Disclosure Regime (RDR). This would require the same recognition and measurement as full NZ IFRS (i.e. Tier 1) but with reduced disclosures.
133. The AASB has adopted this approach with the reduced disclosures based on those under IFRS for SMEs.
134. The XRB favours the RDR approach primarily because it would retain the recognition and measurement requirements of full NZ IFRS. The XRB sees a number of advantages from this including:
  - preparers and users need to be familiar with only one set of recognition and measurement requirements which are applied in both tiers;
  - the comparability of financial information between tiers is enhanced;
  - the preparation of consolidated financial statements where a group comprises entities in both tiers is simplified; and
  - the movement of entities between tiers is easier and less costly.
135. Adopting an RDR that is common with Australia would also enhance harmonisation with Australia because it would eliminate current Tier 2 reporting differences and, therefore, compliance costs for companies with trans-Tasman reporting obligations. This is an important consideration in the for-profit sector.
136. There will be costs associated with developing and maintaining RDR concessions because the reduced disclosure requirements would need to be identified each time a new NZ IFRS (or amendment to a NZ IFRS) is issued. However, these costs are unlikely to be substantial and would be shared with the AASB.
137. Although adopting an RDR approach would result in harmonisation with Australia it does not necessarily improve harmonisation with other countries, particularly those that have adopted IFRS for SMEs. Another option would be to allow Tier 2 entities to adopt either RDR or IFRS for SMEs. This would be a particular advantage in the (likely to be relatively rare) situation where a parent entity of a New Zealand subsidiary is required to prepare consolidated financial statements in a country where IFRS for SMEs has been adopted without amendment. In these circumstances, the costs of compiling the financial information for the consolidated financial statements would be reduced for the New Zealand subsidiary.
138. On the other hand permitting a choice would increase the complexity of the financial reporting framework. There would be a commensurate increase in costs

for preparers and auditors as they would need to understand, apply and audit another set of financial reporting requirements. It would also be more difficult for users because similar entities could be applying different recognition and measurement requirements. It would also reduce the degree of harmonisation with Australia.

139. On balance, the XRB considers that the costs of allowing entities such a choice would exceed the benefits for a country as small as New Zealand.
140. The XRB therefore proposes that NZ IFRS RDR consisting of the same recognition and measurement requirements as Tier 1 (full NZ IFRS) but with reduced disclosures, harmonised with Australia, apply to Tier 2.

#### Tier 3: NZ IFRS Diff Rep and Tier 4: Old GAAP

141. As previously outlined, the purpose of for-profit Tiers 3 and 4 is to maintain, as an interim measure, the status quo for entities currently reporting in accordance with NZ IFRS differential reporting or Old GAAP. Old GAAP comprises the suite of standards (domestic FRSs and SSAPs) that were used prior to the adoption of NZ IFRS.
142. The XRB proposes that the existing suites of standards continue to apply for these two tiers. It sees little benefit in making changes to the accounting standards requirements for entities for which the Government has decided general purpose financial reports should no longer be required.

#### Accounting Standards for Public Benefit Entities

##### Modified IPSAS

143. An implicit part of the multi-standards approach outlined above is the adoption of a set of accounting standards for PBEs other than one based on IFRS. There are two options to achieve this: developing a unique set of New Zealand PBE standards; or developing a New Zealand variation of relevant international standards.
144. In considering these options the XRB starts with the cost-benefit presumption that New Zealand should adopt international standards whenever they are available, provided that they are credible. Standard setting costs are minimised and international comparability and credibility are maximised by doing so. This means developing a unique set of New Zealand standards should be avoided if at all possible.
145. The only set of international accounting standards, other than IFRS, is IPSAS. As previously outlined, the XRB considers IPSAS provides a better basis for PBE reporting than does IFRS because it is being developed for a wider set of users, notably service recipients as well as resource providers.
146. The XRB also considers that IPSAS is a credible set of standards. The major historical concerns about IPSAS have been the lack of a conceptual framework and the lack of independent governance arrangements for IPSASB (at least compared

to those applying to the IASB). The XRB considers that these concerns are being addressed by both IPSASB and the International Federation of Accountants (IFAC – IPSASB’s parent body). The progress on these issues is encouraging and the momentum relatively comforting compared to the position two to three years ago.

147. There remains, however, some on-going concern that, despite the positive “direction of travel”, the governance issues have not yet been fully resolved. Further, the IPSASB conceptual framework is still under development, although again the indications are positive.
148. Given these factors, the XRB considers that it is premature to adopt “pure” IPSAS (in the way that NZ IFRS reflects “pure” IFRS). Some degree of “domestic insurance” (as one constituent put it) is required over the short to medium term to ensure that any aspects of IPSAS that are considered inappropriate in the New Zealand context can be addressed in our version of the standards.
149. The XRB therefore proposes that a set of PBE Accounting Standards (PAS) be developed and that they use IPSAS as their base. PAS would modify IPSAS for any recognition, measurement or disclosure matters considered inappropriate in the New Zealand context at this time. Such modifications would only be made where the IPSAS requirement in question would have a material impact on the financial position or performance being reported, and that impact would adversely detract from the financial statements’ usefulness to users. Based on work to date, the number of modifications is expected to be relatively few.
150. The XRB also proposes that PAS include other relevant standards (including domestic standards) appropriate for New Zealand and/or to address topics not covered in IPSAS.
151. Thirdly, the XRB proposes PAS be modified to make them relevant, applicable and understandable to not-for-profit sector preparers and users. This is necessary because IPSASB has developed IPSAS for public sector entities. Some modification is desirable to enhance their usefulness in the not-for-profit context.

#### Tier 1: Full Standards

152. The XRB proposes that the accounting standards for Tier 1 entities should be the full PAS. This reflects the relative costs and benefits of reporting by entities in this tier. This approach is also consistent with that proposed for the for-profit sector where full NZ IFRS standards apply to Tier 1.

#### Tier 2: Reduced Disclosures

153. The XRB proposes that a RDR version of PAS (PAS RDR) apply to Tier 2 entities. This would use the same recognition and measurement requirements as full PAS but with reduced disclosures.
154. This approach is consistent with that proposed for for-profit sector Tier 2. The same advantages apply.

### Tier 3: Simple Format Reporting Accrual

155. The XRB proposes that PBE Tier 3 entities should prepare their general purpose financial reports in accordance with a simple format reporting approach. This reflects the small size and reduced level of expertise within entities in this tier.
156. It is envisaged that the simple format reporting requirements will be specified within a single standard: PBE Simple Format Reporting Standard – Accrual (PSFR-A). This will be accompanied by optional templates that will identify the various financial and non-financial items to be reported in the financial reports and a suggested format for doing so.
157. In broad terms the recognition and measurement requirements applying to the simple format reporting would be the same as those applying to Tier 1 and 2 entities. However, some concessions will be required to reflect the “simple” nature of the entities in the Tier.

### Tier 4: Simple Format Reporting Cash

158. The XRB proposes that PBE Tier 4 entities should also prepare their general purpose financial reports in accordance with a simple format reporting approach. The reporting requirements will be specified within another single standard: PBE Simple Format Reporting Standard – Cash (PSFR-C). This will be based on PSFR-A but modified for the use of cash accounting.

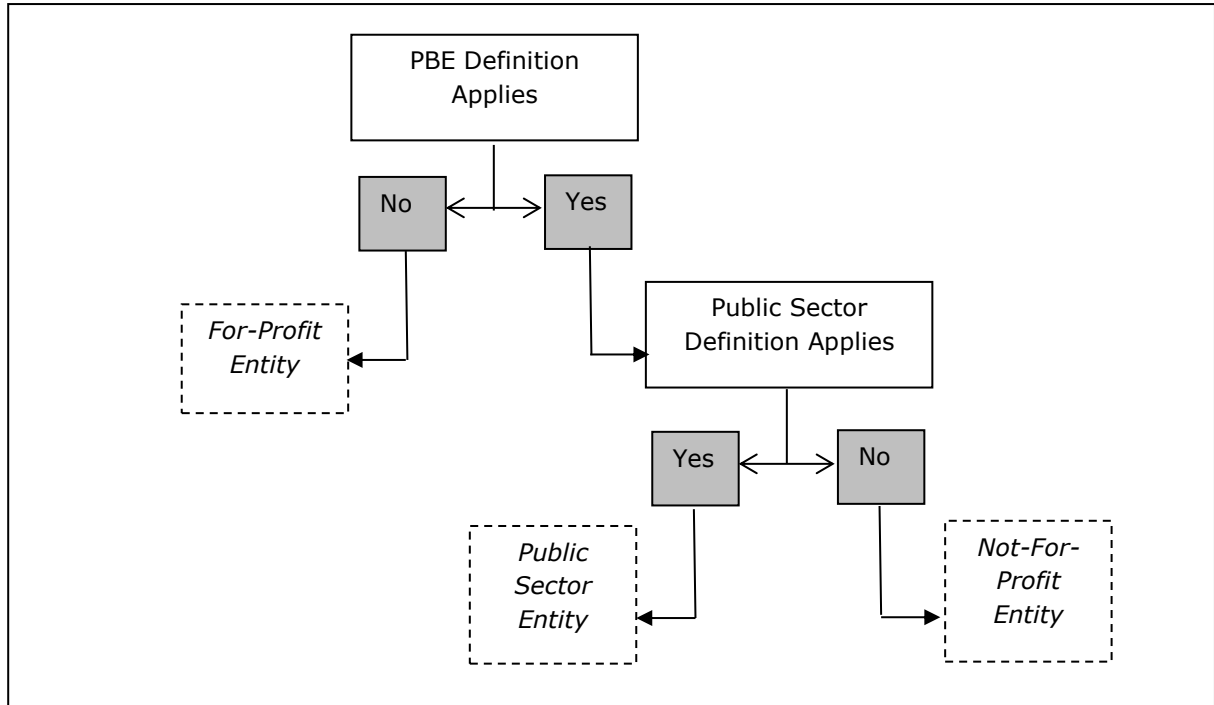
## **3.4 Rationale for Specific Tier Criteria and Requirements**

### *Sector Definitions*

159. The PBE and for-profit entity definitions proposed in paragraph 31 are the same as the equivalent definitions under the existing accounting standards framework. The XRB proposes to use the same definitions because they are generally accepted and well understood.
160. In relation to the definition of Public Sector PBEs and NFP PBEs proposed in paragraph 32, it is commonly accepted that the Auditor-General is responsible for auditing all public sector organisations (although some audits may be contracted out). The Auditor-General’s mandate is therefore generally accepted as being synonymous with what comprises the public sector. The XRB proposes to use this to define the public sector.
161. The Public Audit Act 2001 defines entities that are subject to audit by the Auditor-General as “public entities”. This definition is all encompassing apart from the fact that it excludes the Audit Office itself as it is independently audited. For the purposes of the Accounting Standards Framework definition the Office of the Auditor-General and other Offices of Parliament have been included.
162. NFP PBEs are defined as all other PBEs. This “residual approach” is consistent with the approach used to define for-profit entities and ensures that all entities fall within one category or another.

163. The approach to determining which entities fall into which sector is summarised in Figure 1.

**Figure 1: Definition Decision Tree**



### *For-Profit Tiers*

164. As outlined in Section 3.3, key drivers for accounting standards in the for-profit sector are convergence with IFRS and harmonisation with Australian standards.
165. The XRB considers harmonisation a particularly important factor in establishing the for-profit tier framework given both Government policy<sup>17</sup> and the number of for-profit entities with trans-Tasman reporting obligations. In light of this, the XRB considers it highly desirable that there be a high degree of consistency between the for-profit tier structure and accounting standards in New Zealand and Australia.

### Public Accountability

166. The use of public accountability as the predominant criterion for defining the for-profit tiers as proposed in paragraph 33 is not only consistent with the general tier criteria approach outlined in paragraph 105, it is also consistent with the IASB approach and that adopted by the AASB. Use of public accountability as the primary for-profit criterion therefore enhances international convergence and Australian harmonisation.

<sup>17</sup> The Single Economic Market Outcomes Framework agreed by the New Zealand and Australian Governments in August 2009 includes a specific section on financial reporting. The Outcomes Framework Statements are available at: <http://www.beehive.govt.nz/release/ministers-english-and-swan-progress-trans-tasman-relationship>

167. The second leg of the public accountability definition (the deemed entities) is proposed because the IASB definition is considered to be too narrow in the New Zealand context and does not adequately reflect the New Zealand capital market. The IASB encourages individual jurisdictions to determine how best to apply the definition in their local context so such an approach does not undermine the international convergence objective.
168. The deeming approach, with reference back to legislation, is used in Australia to identify types of entities that are not explicitly mentioned in the IASB definition but, within the Australian regulatory environment, are substantively similar to the type of entities identified by the IASB. Under the AASB's approach the IASB definition must still be applied in the normal manner but, in doing so, account must be taken of the fact that certain types of entities have been "deemed" to be publicly accountable. Deeming these entities removes all doubt as to whether the entities are publicly accountable or not (for the purposes of the Accounting Standards Framework).
169. The XRB considers the deeming approach is relevant and appropriate to the New Zealand situation. One of the features of the New Zealand environment is that around 80% of securities are not traded in a public market (although some of these may fall under the "managed in a fiduciary capacity" part of the IASB definition). In this context the New Zealand market is quite different from markets (for example in Europe) where a higher proportion of securities are traded in a public market. Adapting the definition to reflect the New Zealand financial market context will ensure that all those entities that are publicly accountable provide appropriate information to users.
170. The deeming approach is an effective way to do this. It has the advantage of removing uncertainty as to whether particular types of entities should be regarded as publicly accountable or not. Although some interpretation of the IASB definition might still be required by some entities, the vast majority of entities considered to be publicly accountable in the New Zealand environment will be specifically deemed to be so. This will create greater certainty as to which standards are applicable. Entities not covered by the deeming provisions will still need to consider whether they are captured by the IASB definition. This will require them to apply that definition in the context of their entity in the manner normally required for accounting standards.
171. The rationale for using public accountability to define which entities should be in which tier is that it links to the information needs of investors. The publication of relevant financial information for investors is necessary whenever an entity is managing investors' funds, in other words whenever some form of arms-length investment fiduciary relationship (strong or weak) exists. This occurs regardless of whether the securities are traded or not.
172. The XRB considers that this should be the criterion for determining which entities should be deemed publicly accountable. At the broad level this comprises the categories specified in the IASB definition, namely (a) all issuers (widely defined) and (b) all institutions that hold funds in a fiduciary capacity for a broad group of outsiders as a primary business objective. In the New Zealand context some

entities may be covered by both parts of the definition. This approach has been used to establish the deemed entities in paragraph 34.

173. While the particular legal form and nomenclature are different, the four deemed categories are similar in substance to those deemed to be publicly accountable by the AASB. They therefore effectively result in a harmonised trans-Tasman tier definition.

#### Large For-Profit Public Sector Entities

174. The IASB approach to public accountability (which is what is being proposed as the tier criterion) is different from the more general notion of public accountability often used in relation to the public sector. This reflects the fact that the IASB has a capital markets focus and its definition of public accountability is therefore capital markets related.
175. The XRB considers that in the public sector, accountability exists to the public at large (taxpayers and ratepayers) because entities are publicly owned. In recognition of this wider public accountability obligation, the XRB proposes a specific addition to the for-profit tier criteria be made. This involves classifying large for-profit public sector entities as Tier 1 entities regardless of whether they meet the public accountability criterion or not (i.e. whether or not the entity operates in the capital markets or holds assets in a fiduciary capacity). The XRB considers the benefits of Tier 1 reporting outweigh the costs (broadly assessed) in this instance.
176. Adopting this approach also helps maintain “definitional neutrality” – ensuring a public sector entity ends up in the same tier regardless of whether it is a profit-oriented entity or a public benefit entity. To do otherwise would create inappropriate incentives on entities to define themselves as for-profit or PBE in order to be able to elect a lower tier.
177. As outlined in paragraph 38 the XRB proposes to use expenses as the criterion, and \$30 million as the threshold, to define “large” public sector for-profit entities. This is designed to (a) ensure consistency across the whole public sector (the same measure of large is proposed for PBEs) and therefore to discourage arbitraging between for-profit and PBE frameworks; and (b) simplify the overall financial reporting framework by using the same measure and amount as used in the Government’s framework.

#### Tier 3 and 4 Criteria

178. As outlined in paragraphs 28 and 110, the purpose of Tier 3 is to retain the status quo for entities currently applying NZ IFRS Diff Rep until the new legislative framework comes into force. A large number of Tier 3 entities (quite possibly the majority) are expected to no longer prepare GAAP based financial statements when this occurs. The criteria and requirements proposed for this tier therefore reflect the status quo.
179. Similarly, the purpose of Tier 4 is to retain the status quo for entities currently applying Old GAAP until the new legislative framework comes into force. It is



expected that nearly all Tier 4 entities will no longer prepare GAAP based financial statements when this occurs. The criteria and requirements proposed for this tier therefore also reflect the status quo.

### *PBE Tiers*

180. The use of entity size and public accountability as the tier criteria for the PBE sector is consistent with the tier approach outlined in paragraph 105.
181. The use of expenses as the criterion to define entity size is considered a more appropriate proxy for cost and benefit in the PBE context than revenue because PBE financial performance is typically driven by expenses rather than revenue. Expenses are considered more reflective of the underlying activity of PBEs.
182. The use of \$30 million as the threshold is designed to simplify the overall financial reporting framework by using the same measure and amount as used to define large in the Government's framework.

### *Accounting Standards*

183. The accounting standards proposed for each tier are consistent with the rationale outlined in Section 3.3 above.

## **3.5 Consistency with Legislative Objective**

184. Section 34 of the Act specifies that the purpose of the Tier Strategy is to

*"establish a system for tiers of financial reporting that impose different financial reporting requirements in respect of different classes of relevant entities in order to ensure that the requirements that apply in respect of those entities are appropriate"*.
185. The XRB considers the proposed Accounting Standards Framework specified in Section 2 and explained in Sections 3.1.to 3.4 meets this legislative objective. The proposed Accounting Standards Framework establishes:
  - A system of financial reporting tiers consisting of four tiers for each of two sectors;
  - The criteria to determine which entities are eligible to be in each tier with the criteria being such that each tier will comprise different classes of entities; and
  - Different accounting standard requirements for each tier that are appropriate for the entities concerned because, in the Board's view, they reflect the relative cost and benefits (assessed in a general way) of reporting by entities, including taking into account international convergence and Australian harmonisation objectives.
186. However, the XRB notes that ultimately whether a set of requirements are appropriate for entities or not is dependent on the specific content of the specific accounting standards that they are required to apply. It is therefore the interface

between the system of tiers and the detailed requirements within the system that determines appropriateness. The XRB is conscious of this and will bring that philosophy to bear in developing and amending the various suites of standards.

## 4. Consultation Undertaken

### 4.1 Overview

187. In the process of developing this proposed Accounting Standards Framework the XRB undertook an extensive consultation process with the accounting standards constituency. That constituency comprises the preparers, auditors, and users of general purpose financial reports that are, or will be, prepared under the current accounting standards framework or the proposed new Accounting Standards Framework, together with their advisors. This group encapsulates those persons or organisations the Board is required to consult with in accordance with section 34B(4) of the Act.
188. The consultation undertaken by the XRB occurred in two phases linked to the issue of a Discussion Document in 2009 and then two Consultation Papers in 2011.

### 4.2 ASRB Discussion Document

#### *Content of Discussion Document*

189. In September 2009 the ASRB issued a Discussion Document outlining proposals for a new accounting (and assurance standards) framework for general purpose financial reporting in New Zealand (the Discussion Document)<sup>18</sup>. The ASRB Discussion Document accompanied a Ministry of Economic Development (MED) discussion document which outlined a proposed new financial reporting framework<sup>19</sup>.
190. The MED Document considered the circumstances under which the law should impose requirements on entities to prepare, publish and obtain assurance on General Purpose Financial Reports (GPFR). The ASRB Document outlined the Board's tentative proposals on the accounting standards to be used by entities required to prepare GPFR under the MED Document.
191. The ASRB Discussion Document considered four main issues:
- Some broad proposals for how the (then) anticipated XRB might organise itself;
  - Whether there should be tiers of reporting, and if so the qualifying criteria for each tier;
  - The general nature of the accounting standards that should apply to each tier; and

---

<sup>18</sup> The discussion document was entitled "Proposed Application of Accounting and Assurance Standards under the Proposed New Statutory Framework for Financial Reporting" and is available on the ASRB website: [http://www.asrb.co.nz/Site/Financial\\_Reporting/Discussion\\_Document.aspx](http://www.asrb.co.nz/Site/Financial_Reporting/Discussion_Document.aspx).

<sup>19</sup> The MED document is entitled "The Statutory Framework for Financial Reporting" and is available on the MED website: [www.med.govt.nz](http://www.med.govt.nz).

- The assurance requirements that should apply to each tier.<sup>20</sup>
192. In broad terms the ASRB Discussion Document proposed a multi-standards framework with IFRS based standards for for-profit entities, IPSAS based standards for public sector PBEs, and an IPSAS based "NFP Application" for not-for-profit PBEs. It also proposed the use of tiers in each sector with differential reporting in the lower tiers to help match reporting costs and benefits. These proposals were reflective of the proposals contained in this document.
193. The Discussion Document was made available on the ASRB and MED websites. Its existence was advised via the ASRB's mailing list, MED's contact list and through NZICA communications to its membership.

### *Consultation Results*

194. Submissions on the Discussion Document closed at the end of January 2010. Seventy-six submissions were received from academics, accounting firms, for-profit entities, public sector entities, not-for-profit entities, and professional accounting bodies in both New Zealand and Australia. A list of respondents is contained in Appendix 1.
195. After undertaking an initial review of submissions the ASRB concluded that the number of submissions (which was a large number compared to historical submission numbers), and distribution across sectors and entity type was sufficient to provide a reasonable representation of the views of the financial reporting constituency.
196. There was common agreement amongst the respondents that GPFR needs to be focused on meeting user information needs, that a sectoral distinction is useful when considering user-needs, and that the current standards do not adequately address the diversity of these needs. In other words, there was broad agreement that the status quo is not satisfactory.
197. However, there were mixed views about whether a sectoral-specific approach was the best way to address these issues. Around 48% of respondents supported a multi-standards approach, 25% supported a single-standards approach, 24% expressed no view and 3% were indifferent. An analysis of responses by entity type indicated that the degree of support for a sectoral-specific approach appeared to be correlated to the extent to which the current framework was viewed as meeting or not meeting particular respondents' needs. In this context the level of support for a multi-standards approach was influenced by the significant number of submissions from respondents who commented on not-for-profit reporting issues and who almost unanimously supported a multi-standards approach.
198. A number of respondents opposed to the multi-standards approach expressed a desire to retain a sector-neutral approach if possible. In considering these comments the ASRB reflected on the fact that the current framework is itself not sector-neutral as NZ IFRS already contains sector specific requirements in the

---

<sup>20</sup> The inclusion of assurance requirements reflected the scope of the MED document. Assurance issues have subsequently been considered separately from the accounting standards framework.

form of PBE specific paragraphs. The move away from sector-neutrality effectively began with the decision in 2002 to adopt IFRS, although that wasn't altogether clear at the time.

### *ASRB Deliberations*

199. After considering the broad shape of this feedback, the ASRB concluded that the key issue for it to consider was whether a single or multi-standards framework should be adopted. This was the area of greatest diversity of views in submissions. It is also fundamental to the overall Accounting Standards Framework approach.
200. In order to fully understand all the matters that would impact this decision the ASRB programmed a series of in-depth discussions on specific Accounting Standards Framework issues. Consideration of these individual issues occurred in a series of ASRB meetings over the following 14 months. Working Groups were also established to consider particular issues and report back their conclusions to the ASRB for its consideration.
201. The in-depth topics considered reflected the various issues raised by respondents to the Discussion Document. They were as follows:
  - Convergence with Australia and the effect this should have on standard-setting;
  - The broad approach to accounting standards for for-profit entities;
  - The viability of IPSAS as an alternative set of standards for use in the PBE public sector;
  - The viability of developing an NFP Application based on IPSAS;
  - The viability of enhanced NZ equivalents as an accounting standards option;
  - Non-technical factors (such as professional specialisation, mobility and education) and how they are impacted by the single vs. multi standards framework options; and
  - The tier structures and criteria.
202. The Board's tentative conclusions were published on the ASRB website as the deliberations on each topic occurred.
203. As part of this process the ASRB evaluated two broad accounting standards framework options: enhanced NZ IFRS equivalents (the single standard approach); and the multi-standards approach. After considering the reports of Working Groups established for the purpose, the ASRB concluded that both options were technically viable.
204. The ASRB then considered cost-benefit issues and concluded that user-needs should be the primary criterion to assess the two options. For the reasons outlined in Section 3.1 the ASRB concluded that user-needs cannot be adequately

addressed by a single set of accounting standards, and that a multi standards approach should be adopted. This conclusion was considered and confirmed by the XRB when it came into existence as a reconstituted ASRB on 1 July 2011. It established the overall structure for the Accounting Standards Framework as outlined in this document.

205. The XRB developed a Position Paper which outlined the ASRB/XRB's conclusions in relation to the multi-standards framework, including the basis for reaching those conclusions and the broad structure of that framework. That Position Paper was published in September 2011.<sup>21</sup>
206. The XRB did not seek further feedback on the Position Paper as it considered that the matters contained in it had been adequately consulted on as part of the Discussion Document process and that the ASRB had undertaken a very thorough consideration of the issues raised. Informal feedback from the constituency also indicated a general degree of comfort with the process followed by the ASRB and an eagerness for the XRB to make a definitive decision about the overall shape of the accounting standards framework.

### 4.3 XRB Consultation Papers

#### *Content of Consultation Papers*

207. The Position Paper reflected the XRB's strategic level decision about the overall shape of the new Accounting Standards Framework. The next step was to establish the detailed elements of that framework. The XRB's specific proposals in that regard were contained in the two Consultation Papers:
  - Accounting Standards Framework for General Purpose Financial Reporting by For-Profit Entities; and
  - Accounting Standards Framework for General Purpose Financial Reporting by Public Benefit Entities.<sup>22</sup>
208. The Consultation Papers were released in September 2011 and the timing of their release was coordinated with the release of the Government's announcement of its decisions on the new statutory financial reporting framework.
209. The XRB Consultation Papers outlined specific proposals for the number of tiers, the criteria for allocating entities to tiers, the accounting standards that will apply to each tier, and the process and timing for adopting the new frameworks in each sector. These covered all the matters included in the proposed Accounting Standards Framework that had not been dealt with in the Position Paper.

---

<sup>21</sup> The Position Paper is entitled "Accounting Standards Framework: A Multi Standards Approach" and is available on the XRB website: [www.xrb.govt.nz](http://www.xrb.govt.nz).

<sup>22</sup> These Consultation Papers were issued at the same time as the Position Paper and are available on the XRB website: [www.xrb.govt.nz](http://www.xrb.govt.nz).

210. The XRB sought comments from the constituency on the detailed aspects of the framework outlined in the Consultation Papers, together with any other comments constituents wished to make.
211. The XRB undertook an extensive communications programme to make the constituency aware of the Consultation Papers. This included:
- Publishing it on the XRB and MED websites;
  - Promoting it through the XRB's communique list and the MED's contact list;
  - Writing to key individuals and major organisations;
  - Working with sector umbrella groups to promote it to member organisations;
  - Promoting it through NZICA communications to its members;
  - A series of half-day seminars held in Auckland, Hamilton, Wellington and Christchurch attended by over 1000 participants;
  - Various other speaking engagements; and
  - Other initiatives, including a webinar and a podcast.

### *Consultation Results*

212. Submissions on the Consultation Papers closed on Friday 16 December 2011. A total of 99 submissions were received (an almost unprecedented number for accounting standards issues): 34 on the for-profit Consultation Paper; and 65 on the PBE Consultation Paper. Nineteen respondents made submissions on both Consultation Papers. A list of respondents is in Appendix 2.
213. Submissions were received from a wide cross-section of the constituency including the financial markets regulator, all the large accounting firms and most of the medium sized firms, New Zealand and Australian professional accounting bodies, a number of for-profit entities (7 large, 1 non-large, 1 other), the key public sector oversight and/or umbrella entities, a number of individual public sector entities – mostly PBE financial institutions or registration boards, the major NFP umbrella organisations, key church bodies, a number of individual NFP entities, and a number of individuals.
214. Having considered the number and source of submissions the XRB concluded that it was sufficient for the XRB to use as the basis for final decisions.

### For-Profit Framework

215. In relation to the for-profit accounting standards framework, there was a general level of agreement with the Consultation Paper proposals i.e. two tiers, use of public accountability (and deeming) to define the tiers, inclusion of large for-profit entities (defined as expenses of \$30 million) in Tier 1, full NZ IFRS for Tier 1, and

NZ IFRS RDR for Tier 2. There was also general agreement that entities currently applying NZ IFRS Diff Rep and Old GAAP (i.e. Tiers 3 and 4) should be able to continue to do so until the legislative changes come into force.

216. A few respondents indicated a preference for recognition and measurement concessions as well as disclosure concessions for Tier 2, or alternatively allowing two options for that tier - RDR or IFRS for SMEs. A small number of respondents (all individuals) advocated ceasing to use IFRS and replacing it with old GAAP.

#### PBE Framework

217. There was broad (but not unanimous) agreement with the PBE Accounting Standards Framework Consultation Paper proposals including the use of IPSAS as the base for PBE standards. However:
- A few respondents (mainly the large accounting firms) expressed concern about the multi-standards approach. These respondents expressed a preference for the PBE standards to be based on IFRS rather than IPSAS.
  - Some respondents that are PBE financial institutions expressed reservations about whether IPSAS is appropriate for their users and expressed a desire to be able to use IFRS (or have the choice); and
  - A significant number of respondents expressed concerns, or raised questions, about how the consultation proposals will apply in mixed groups (groups with both for-profit and PBE entities) and whether restatement would be required and the cost of doing this.
218. There was general agreement with the proposed PBE tiers. However:
- A few respondents suggested the cash accounting sub-tier (proposed to be part of Tier 3 in the Consultation Paper) should be established as a separate Tier 4; and
  - Many respondents requested clarity about what would comprise expenses for tier threshold purposes, with various views about what it should and should not contain – a few also suggested that an asset criterion should be added to the tier thresholds.
219. In relation to the criteria for allocating entities to tiers:
- Most respondents agreed that all issuers should be required to report in accordance with Tier 1 requirements 1; and
  - Most respondents agreed that all coercive leviers should be required to report in accordance with Tier 1 requirements as proposed in the Consultation Paper. However, a few knowledgeable respondents, most notably the Department of Internal Affairs and the Office of the Auditor-General, expressed concern that this would result in a disproportionately high cost for small local authorities.



220. There was general agreement with the proposals for PAS RDR for Tier 2.

### *XRB Deliberations*

#### For-Profit Framework

221. The XRB considered the feedback on the for-profit Consultation Paper and concluded that there was general support for the proposals without requiring significant change.
222. In relation to the comments about NZ IFRS and IFRS for SMEs outlined in paragraph 216, the XRB noted that these same comments had been made in the Discussion Document consultation process. No new information had resulted from this second consultation round. The XRB concluded that NZ IFRS and NZ IFRS RDR are the most appropriate accounting standards for the reasons outlined in Section 3.

#### PBE Framework

223. The XRB considered the feedback on the PBE Consultation Paper and concluded that there was general support for the broad thrust of the proposals. However, there were a number of specific matters that warranted further consideration. These are outlined below.
224. The XRB considered the concerns about the multi-standards approach raised as part of the feedback on the PBE Consultation Paper. The XRB noted that these concerns were only raised by a small number of respondents, while a large number of respondents (particularly from within the PBE sector) indicated their continued support for the XRB's decision. The XRB concluded that no new information had been provided to suggest that the multi-standards decision should be revisited.
225. The XRB considered the issue raised by the PBE financial institutions (whether they should have the option to use NZ IFRS rather than PAS). It then undertook some limited further discussions with them and other key stakeholders. It has become clear that there are disparate views about the issue amongst stakeholders and that as the issue had not been raised in response to the 2009 Discussion Document, the Board had not consulted on the matter as part of the 2011 Consultation Papers. The XRB considers that the issue is one that warrants further investigation. However, it has been unable to consider the issue in detail, or consult with the wider stakeholder group, in the short period since the submissions on the Consultation Papers were received. The XRB has therefore established a project to consider the matter raised and will propose an amendment to the Accounting Standards Framework should it consider that a change is required as a result of that project.
226. The XRB agreed that guidance on reporting by mixed groups should be included in the relevant accounting standards and consulted on through the normal exposure draft process.

227. The XRB considered the feedback about the (then) proposed cash sub-tier. It concurred with the respondents' suggestion that the accounting standards for entities authorised by Law to use cash accounting should be reflected in a separate Tier within the tier structure (Tier 4). Such an approach is likely to assist understanding and communication of the tier structure. This decision is reflected in the tier structure included in Section 2 of this document
228. The XRB also agreed that "expenses" needed to be defined for the purposes of the tier framework. Having considered the matter it concluded that an asset criterion was not a good indicator of the relative cost and benefits of reporting by PBEs. These decisions are also reflected in the tier structure included in Section 2 of this document.

#### **4.4 Consultation Adequacy**

229. The XRB considers that reasonable steps have been taken to make persons or organisations or representatives of persons or organisations who, in the opinion of the Board, would be affected by the changes to the Accounting Standards Framework aware of the proposals and to encourage them to make a submission. This is consistent with the XRB's statutory duty under section 34B(4) of the Act.
230. The XRB also considers that it has carefully considered the feedback received from respondents to the 2009 Discussion Document and the 2011 Consultation Papers. It considered that feedback in the context of the user-needs, cost-benefit approach it has used to develop the Accounting Standards Framework and adjusted its proposals where appropriate.
231. Based on the consultation undertaken, and the formal and informal feedback received from the constituency, the XRB considers that the proposed Accounting Standards Framework contained in Section 2 of this document has the general support of the constituency, except in relation to the PBE Financial Institutions issue discussed in paragraph 225. As discussed in that paragraph the XRB has initiated a project to consider that issue and will propose an amendment to the Accounting Standards Framework if it considers a change is warranted.

## 5. Implementation

232. The XRB proposes that the new Accounting Standards Framework be implemented in a staged way by sector. The proposed timeline for when the new Accounting Standards Framework would be effective (i.e. required to be complied with by reporting entities) is as follows:

- For-profit accounting standards framework:
  - Initial four-tier framework: from 1 October 2012, with adoption permitted for periods beginning before that date.
  - Revised two-tier framework:
    - From the date the legislative amendments relating to financial reporting by small and medium companies come into force (this means Tier 3 and Tier 4 would be revoked from that date).
    - Tier 3 and Tier 4 Entities that meet the criteria for Tiers 1 or 2 after that date would be required to report in accordance with the relevant tier for any financial years beginning on or after 12 months of the legislation coming into force.
- PBE accounting standards framework:
  - Public sector PBEs: for periods beginning on or after 1 July 2014 (2014/15 financial year). Earlier application would not be permitted (so the whole public sector adopts the new standards at the same time).
  - Not-for-profit PBEs: for periods beginning on or after 1 March 2015, or such later date as the legislative amendments come into force. Early application (of the whole suite of standards) would be allowed from the date the standards are issued.

233. In order for this timeline to be achieved the XRB will need to issue the new suites of standards by the following dates:

- NZ IFRS RDR: September 2012;
- PAS, PAS RDR, PSRF-C and PSFR-A as they apply to public sector entities: March 2013;
- PAS, PAS RDR, PSRF-C and PSFR-A as they apply to not-for-profit entities: March 2014.

234. The XRB has established a work programme, which includes appropriate consultation processes, accordingly.

## **Appendix 1 – Respondents to the 2009 Discussion Document**

Alan Spencer  
Amalgamated Dairies  
ANGOA  
ANZ National  
Auckland City Council  
BDO  
Bill Heritage  
Caritas  
Carolyn Cordery and Rowena Sinclair  
Catholic Diocese of Auckland  
Charities Commission  
Community Waikato  
Community Waitakere  
Dan Cater  
Deloitte  
Electricity Networks Association  
Ernst & Young  
Five Medium Sized Accounting Firms  
Fletcher Building  
Fonterra  
Foodstuffs (NZ) Ltd  
Genesis Energy  
Giltrap Group  
Grant Thornton New Zealand  
Hayes Knight  
Helensville & District Historical Society  
Hynds  
Ian Kennedy  
Inter Church Working Party  
John Wallis  
Joint Accounting Bodies – Australia  
King's College  
KPMG  
Landcorp  
M J Carter  
Massey University  
Meridian Energy  
Michael Gousmett  
Mighty River Power  
Ministry of Education  
Morrinsville Community House  
New Zealand Business Roundtable  
New Zealand Catholic Bishop's Conference

New Zealand Defence Force  
New Zealand Federation of Voluntary Welfare Organisations  
New Zealand Society of Local Government Managers  
New Zealand Wool Testing Authority  
New Zealand Institute of Chartered Accountants  
Office of the Auditor-General  
Peter Hays  
Philanthropy New Zealand  
Presbyterian Church of New Zealand  
Presbyterian Support  
PricewaterhouseCoopers  
Retirement Villages Association  
Richard Lockhart & Associates  
Securities Commission  
Southland Interagency Forum  
St George's Hospital  
Sue Malthus  
Tairāwhiti Community Law Trust  
Te Anau Bowling Club  
Te Runanga o Ngati Awa  
The Treasury  
The Whyte Group  
Trust Waikato  
Trustee Corporation Association  
Unitec New Zealand  
University of Auckland Business School  
University of Wollongong  
Venture Southland  
Volunteering New Zealand  
Waihi Community Resource Centre Inc  
Wellington City Council  
Whanganui Community Foundation

## **Appendix 2 – Respondents to the 2011 Consultation Papers**

### **Respondents to the 2011 Consultation Paper: Accounting Standards Framework for For-Profit Entities**

BDO New Zealand Ltd  
Bill Heritage  
BNZ  
Christchurch City Holdings Ltd  
Cookson Forbes & Associates Ltd  
Corporate Sector Advisory Group of NZICA  
CPA Australia and the Institute of Chartered Accountants in Australia  
CST Nexia Chartered Accountants  
David J Turner  
Deloitte  
Development West Coast  
Electricity Networks Association  
Ernst & Young  
Financial Markets Authority  
Fonterra Co-operative Group Limited  
Foodstuffs (N.Z) Ltd  
Gourmet Paprika Ltd  
Grant Thornton New Zealand  
The Guardians of New Zealand Superannuation  
Hayes Knight Chartered Accountants  
KPMG  
Dr M. Humayun Kabir  
Manawatu Public Practitioners  
Marsden B Robinson  
The New Zealand Institute of Chartered Accountants  
Office of the Auditor-General  
Peter Bould  
PwC  
The Retirement Villages Association of New Zealand Inc  
SkyCity Entertainment Group Limited  
Sylvan Consultants Ltd  
Tranzit Group Ltd

## Respondents to the 2011 Consultation Paper: Accounting Standards Framework for Public Benefit Entities

The Accident Compensation Corporation (ACC)  
The Association of NGOs of Aotearoa (ANGOA)  
Arran Chartered Accountants Limited  
ASB Community Trust  
Australian Government Department of Finance and Deregulation  
Barry Davis  
BDO New Zealand Ltd  
Christchurch Community Accounting  
CPA Australia and the Institute of Chartered Accountants in Australia  
Credit Union Baywide  
CST Nexia Chartered Accountants  
The Deer Industry New Zealand  
Deloitte  
The Department of Internal Affairs  
Devadunna Abeynaike  
Development West Coast  
Diane Robinson  
Edward Anderson  
Ernest R Yeoman  
Ernst & Young  
Financial Markets Authority  
Gavin Hampton  
Graeme Potter  
Grant Thornton New Zealand  
Greg Brewerton  
The Guardians of New Zealand Superannuation  
Hayes Knight Chartered Accountants  
Housing New Zealand Corporation  
Inter Church Working Party  
Kelvin C. Deal Accountants  
KPMG  
Lellman Wearne Curragh Limited  
Lloyd Brewerton  
Manawatu Public Practitioners  
Manor Group Charitable Trust  
Manukau Christian Charitable Trust  
Marlborough District Council  
The Methodist Church of New Zealand Te Hahi Weteriana o Aotearoa  
New Zealand Council of Social Services and Wellington Council of Social Services  
The New Zealand Institute of Chartered Accountants  
New Zealand Psychologists Board  
New Zealand School Trustee Association  
New Zealand Society of Local Government Managers

Nursing Council of New Zealand  
NZ Nurses Organisation  
Office of the Auditor-General  
The Pharmacy Council of New Zealand  
Presbyterian Support New Zealand Inc  
Prison Fellowship New Zealand  
Problem Gambling Foundation of New Zealand  
PwC  
The Reserve Bank of New Zealand  
The Retirement Villages Association of New Zealand Inc  
Roman Catholic Bishops in New Zealand  
Rowena Sinclair  
Social Development Partners  
Sylvan Consultants Ltd  
The Treasury  
Trust Waikato  
Wellington Catholic Homes Trust  
Wellington City Council