



15 November 2019

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Tēnā koe Michele

Targeted Review of the New Zealand Accounting Standards Framework - Discussion Paper

1. We appreciate the opportunity to comment on the External Reporting Board's (XRB's) Discussion Paper *Targeted Review of the New Zealand Accounting Standards Framework*.
2. We note below our high-level comments on alignment between PBE Standards and IPSAS. Our responses to the Questions for Respondents are attached to this letter and should be read in conjunction with this letter.

Alignment between PBE Standards and IPSAS

3. It is important for New Zealand to have accounting standards that meet user needs and that serve the best interests of New Zealand, subject to cost-benefit considerations. The XRB's strategy in its Accounting Standards Framework (ASF) is to base New Zealand accounting standards on international standards, and to this end:
 - adopt International Financial Reporting Standards (IFRS) without modification for for-profit entities; and
 - use International Public Sector Accounting Standards (IPSAS) as a base for PBE Standards for public benefit entities (PBEs).
4. We continue to support using IPSAS as a base for PBE Standards in the multi-standards strategy, and support maintaining a close alignment between them, to the extent it results in relevant PBE Standards for New Zealand, both for the public sector and the not-for-profit sector.
5. We think it is important to be able to state that PBE Standards are based on IPSAS, which is an internationally recognised suite of standards that is inherently suitable for PBEs. We think it is right to have a presumption or expectation that an IPSAS will be adopted in New Zealand (with appropriate modifications made for PBEs), and believe there needs to continue to be a high hurdle in place to override such a presumption or expectation.

6. We understand that the recent developments set out in the Discussion Paper were anticipated when the XRB decided to base PBE Standards on IPSAS. They formed the basis of the *Policy Approach to Developing the Suite of PBE Standards* (PBE Policy Approach). The PBE Policy Approach sets out the approach for the NZASB to modify IPSAS or further develop PBE Standards where this is appropriate to ensure a relevant and high quality suite of PBE Standards in New Zealand.
7. We think there is already flexibility in the current PBE Policy Approach for the NZASB to use its best judgement to modify IPSAS or further develop PBE Standards, where necessary, and to develop standards ahead of the IPSASB, where appropriate, to address timing issues. However, we acknowledge that the degree of flexibility is not particularly clear. We think it would be helpful to set out clearly the circumstances in which it is appropriate to make modifications to an IPSAS, or not to adopt an IPSAS.
8. A PBE Policy Approach that was clearer would ensure a transparent and robust process for NZASB's decisions and provide a framework for interested stakeholders to understand how, and why, particular PBE Standards have been developed. We are of the view that it is essential for the NZASB to continue to apply a PBE Policy Approach that contains a presumption or expectation that IPSAS will be adopted when issued, with appropriate modifications for New Zealand PBEs.
9. It is important to us that the outcome of the Targeted Review is a coherent and conceptually-consistent suite of IPSAS-based PBE Standards that is fit for purpose for users of PBE financial reports.
10. If you have any questions about our submission, please phone Todd Beardsworth, Assistant Auditor-General, Accounting and Auditing Policy on +64 21 244 0727 or email him at todd.beardsworth@oag.govt.nz.

Nāku noa, nā



Greg Schollum
Deputy Auditor-General

Questions for Respondents

General comments

Q 1 Are you aware of any developments in the financial reporting environment (in addition to the ones described in this DP) or any unintended consequences that would require refinements to the ASF?

No, we are not aware of any developments in the financial reporting environment or any unintended consequences that would require a change to the ASF. We do not think that circumstances have changed fundamentally to warrant changing the appropriateness of IPSAS as a base for PBE Standards.

The strategy of aligning PBE Standards with IPSAS results in PBE Standards that best meet the objectives and needs of users of PBE financial reports. We support the ASF, in conjunction with the PBE Policy Approach, for setting PBE Standards. This is in line with the XRB's strategy for multi-standards and for New Zealand standards to be based on international standards, that is, IFRS for for-profit entities and IPSAS for PBEs.

In our view, the recent developments raised in the Discussion Paper as the basis for re-considering the close alignment of PBE Standards with IPSAS are not fundamental. The possibility of such matters arising was anticipated, and was one of the reasons the XRB developed the PBE Policy Approach. The PBE Policy Approach provides the NZASB with a framework for developing PBE Standards based on IPSAS, and that is consistent with the ASF.

We think it is right to have a presumption or expectation that an IPSAS will be adopted for use by PBEs in New Zealand (subject to appropriate modifications). In our view, there needs to continue to be a high hurdle to rebut this presumption or expectation. The issue is then how to operationalise the rebuttable presumption or expectation. We think it is useful for the Policy Approach to set out clear circumstances that would need to be considered to rebut the presumption not to adopt an IPSAS as the base for a PBE Standard.

It is important for New Zealand PBEs to have relevant and high quality PBE Standards. As such, it is essential for the Policy Approach to set out the circumstances in which it is appropriate for the NZASB to make modifications to an IPSAS. There are likely to be different views about what those circumstances should be. In our view, it is just a matter of the Policy Approach being clearer on when modifications to an IPSAS are considered appropriate.

We note that there are positive developments in the PBE financial reporting environment. The XRB's historical concerns about IPSAS included the lack of a conceptual framework and independent governance arrangements for IPSASB. When the ASF was first developed, the XRB decided that it was premature to adopt "pure" IPSAS because, among other matters, IPSAS are developed for public sector entities and the requirements are not always appropriate for not-for-profit entities or do not necessarily fit with the New Zealand regulatory environment. In addition, IPSAS did not represent a complete set of standards. Since the decision to base PBE Standards on IPSAS, the positive developments include:

- IPSASB issued its Conceptual Framework in 2014;
- IPSASB's governance has improved with the setting up of its oversight body, the Public Interest Committee (PIC), in 2015;
- IPSASB is focused on developing standards aimed at specific public sector issues and working towards a more complete and conceptually consistent suite of standards;
- IPSASB continues to work on aligning its standards with IFRS, where appropriate. IPSASB's Strategy and Work Plan 2019–2023 includes a Strategic Theme of *Maintaining IFRS alignment*. This should result in most transactions that are common between the PBE sector and the for-profit sector being accounted for similarly; and
- More countries are now adopting accrual accounting and IPSAS, with adoption of IPSAS expected to further increase in the next few years.

Q 2 Do you have any other comments about the ASF?

The Auditor-General's 2009 report to Parliament *The Auditor-General's views on setting financial reporting standards for the public sector* set out concerns about public sector standard setting in New Zealand, and in particular, about basing standards for PBEs on IFRS¹. The 2009 report, and the XRB's subsequent multi-standards strategy, determined that IPSAS is a credible (and the best alternative) set of international standards to use as a base for PBE Standards. Developed specifically for public sector entities, IPSAS are inherently more suitable for PBEs (than IFRS), ensuring that transactions and events are accounted for appropriately. The current ASF and the approach taken to set PBE Standards were endorsed in the Auditor-General's 2016 report *Improving financial reporting in the public sector* as being positive and setting a better foundation for future reporting by PBEs.

We would not want to see a move away from alignment with IPSAS as a base for PBE Standards, and believe there needs to continue to be a high hurdle in place to override a presumption or expectation that an IPSAS will be adopted with appropriate modifications for New Zealand PBEs. In our view, to do otherwise would require a fundamental first principles review.

SMC 1: Importance of maintaining close alignment between PBE Standards and IPSAS

Q 3 Moving forward, should the XRB's policy for developing PBE Standards prioritise local considerations to ensure that PBE Standards are "fit for purpose" for the New Zealand environment? Or, is maintaining close alignment with IPSAS more important?

Please provide reasons for your response.

The XRB's policy for developing, or adopting, standards should always consider local considerations to ensure standards are fit for purpose for the New Zealand environment. This applies to the adoption of IFRS standards as well as developing PBE Standards. A coherent and conceptually consistent suite of IPSAS-based PBE Standards that is fit for purpose for users of PBE financial reports is, in our view, important.

In developing PBE Standards, whether local considerations should be taken into account depends on whether the standards produce financial reports that readers understand, and that can be used to properly hold PBEs to account. Local considerations include New Zealand legislative requirements, New Zealand PBE-specific issues (including issues relating to not-for-profit entities), or significant mixed group issues.

Adoption of an IFRS and its application at an earlier point in time for for-profit entities (in the absence of an equivalent IPSAS), in our view, does not necessarily create "local considerations" that would need to be prioritised over an IPSAS, or preclude its subsequent adoption. Furthermore, we do not think there should be a presumption that IFRS is always "better" than IPSAS, or that IPSAS must be aligned with IFRS.

Q 4 If you think close alignment between PBE Standards and IPSAS is important, for whom is this important and why?

Close alignment between PBE Standards and IPSAS that results in relevant PBE Standards is important for, and benefits, users of PBE financial reports, New Zealand as a country, and the XRB as a national standard setter.

For users, the benefits include:

- Users have access to PBE financial reports that are relevant and targeted to their needs. Users can have confidence that the PBE financial reports are based on internationally accepted reporting requirements that are relevant and appropriate to non-commercial entities. For public sector entities, whose primary users include Parliament and the public of New Zealand, the resulting financial

¹ IFRS were considered an inappropriate base for standards for PBEs as they are designed for commercial companies listed on stock exchanges.

statements provide information for public sector financial management, accountability and decision-making.

For New Zealand as a country, the benefits include:

- New Zealand benefits from reputational advantages attached to the ability to state that its standards (whether in the for-profit sector or in the PBE sector) are based on international standards. The financial statements of PBEs will have credibility and currency internationally. New Zealand is often highly ranked by international researchers and analysts: for example, the World Economic Forum's Global Competitiveness Report² uses, among other indicators, budget transparency, strength of auditing and reporting standards and incidence of corruption to rank New Zealand first out of 140 countries for Pillar 1 *Institutions*.
- Internationally-based standards result in PBEs having internationally comparable financial reports. Locally developed standards that result in different accounting for PBEs from IPSAS, can adversely affect the ability of international users to understand the Government's financial reports. This could ultimately lead those users to question the reliability and usefulness of the Government's financial reports. Similar to the for-profit sector and the benefits attributed to the adoption of IFRS, PBE Standards that are based on IPSAS enhance the comparability and transparency of the financial statements of the Government and other New Zealand PBEs. This, in turn may lead to economic benefits for the country in the form of lower cost of capital and attracting further international capital investment into New Zealand.

For the XRB as a national standard setter, the benefits include:

- Developing IPSAS-based PBE Standards is more cost-effective than modifying IFRS or developing local standards. This was one of the reasons for the decision to base PBE Standards on IPSAS in the XRB's ASF and multi-standards strategy.
- Aligning PBE Standards with IPSAS ensures a comprehensive, coherent suite of PBE Standards, not just across the individual standards but also with the PBE Conceptual Framework.
- New Zealand has significant skills and expertise in public sector and PBE accounting. Continuing to align PBE Standards with IPSAS provides a pathway for the XRB to continue to participate, contribute to, influence and support good quality public sector and PBE accounting internationally and help raise the standard and quality of those global standards. This allows the XRB to continue to maintain and further enhance New Zealand's leadership, influence and reputation.

Q 5 If you think prioritising local considerations is more important, should the PBE Policy Approach be amended to provide more flexibility in how IPSAS is used as the base for PBE Standards, as suggested under Option 2 in Chapter 4 of this DP?

We do not support amending the PBE Policy Approach to provide unfettered flexibility in how IPSAS is used or in allowing a move away from IPSAS as a base for PBE Standards. Option 2, as expressed in the Discussion Paper, gives the NZASB a level of flexibility that we consider to be unwarranted.

We are also concerned that providing too much flexibility to modify underlying IPSAS could lead to significant and unnecessary delays in introducing a new or amended IPSAS into the PBE Standards. For example, the NZASB issued PBE IPSAS 40 *Public Benefit Entity Combinations* two and half years after the IPSASB issued IPSAS 40 *Public Sector Combinations*. This means the mandatory effective date of PBE IPSAS 40 was two years later than the mandatory effective date for the underlying IPSAS 40. We question whether the delay in developing PBE IPSAS 40 was necessary as many of the changes made were not of significance to the effective operation of that standard in practice.

As explained in our cover letter, we broadly support PBE Standards continuing to be based on IPSAS and applying the PBE Policy Approach where necessary. The PBE Policy Approach should continue to have a high hurdle for the NZASB to override the presumption or expectation that IPSAS will be adopted when

² For example, New Zealand was ranked best performer out of 140 countries for Pillar 1 *Institutions* in the World Economic Forum's Global Competitiveness Report 2018. Pillar 1 ranked New Zealand on a number of factors including budget transparency, strength of auditing and reporting standards and incidence of corruption.

issued. The current PBE Policy Approach has flexibility within the framework to enable the NZASB to develop relevant PBE Standards for New Zealand PBEs. However, we agree that the degree of flexibility could be made clearer in the PBE Policy Approach, to include the circumstances in which it is appropriate to make modifications to an IPSAS, or to rebut the presumption or expectation not to adopt an IPSAS.

Q 6 Do you have any other comments on the way IPSAS are used as the base for PBE Standards?

We note that the Discussion Paper raises the following as a recent development for considering whether to continue to maintain close alignment with IPSAS:

- The issuing of several new IFRS Standards, with IPSAS projects lagging behind.

We note that timeliness in setting standards is not an IPSASB-specific issue. Many international standard setters, including the IASB, suffer from the same criticism. For example, the IASB's standard on insurance contracts took about 18 years (1999-2017) to develop, the standards on leases took about 10 years (2006-2016) and the standard on revenue took about 12 years (2002-2014). In this context, we think that the IPSASB is generally performing well in terms of timeliness in issuing IPSASs. Even if an IFRS represents IASB's latest thinking, it might not be appropriate for PBEs. The IPSASB should be given an opportunity (and sufficient time) to consider all relevant issues relating to standards to ensure any subsequent IPSAS is appropriate and of high quality.

While the time lag issue has implications for mixed groups, we are not aware of significant issues being raised in the context of mixed groups. Most public sector entities cope with making the necessary adjustments on consolidation. Moreover, other than financial instruments which permeated and affected most entities, the impact of other standards (for example, leases and insurance contracts) are limited to selected entities. In such instances, a time lag difference between the for-profit sector and the PBE sector is unlikely to cause a fundamental disruption.

There appears to be an underlying presumption in the Discussion Paper that the IPSASB and IPSAS have to continue to align and/or "keep up" with the IASB and IFRS. Most international standards that attempt to cater to international constituents contain compromises. New Zealand's adoption of IFRS without modification should not be used as a "benchmark" for IPSAS. IPSAS, similar to IFRS, will not be ideal for New Zealand in every instance but, in our view, IPSAS are still the most credible and appropriate base for PBE Standards.

In basing PBE Standards on IPSAS, we are of the view that modifications should be made only where the issue is considered to be substantive. It would also be useful for the Basis for Conclusions to clearly identify any changes to IPSAS.

SMC 2: Importance of retaining harmonisation with Australia for Tier 2 for-profit disclosures

Q 7 How important is it to retain harmonisation with Australia for Tier 2 for-profit entity disclosure requirements?

Please provide reasons for your response.

Q 8 If you think it is important to retain harmonisation with Australia for Tier 2 for-profit entity disclosure requirements, for whom is this important and why?

Q 9 Do you have any other comments about the harmonisation with Australia for Tier 2 for-profit disclosure requirements?

We agree it would be useful to have Tier 2 for-profit requirements aligned with Australia where possible. However, in the public sector, we do not see a need to do so. Further, PBE Tier 2 requirements should not be driven by New Zealand-Australian harmonisation in the for-profit sector.

We note that there is no separate framework for determining reduced disclosure requirements for Tier 2 PBEs. We consider it desirable to have a separate framework for Tier 2 PBEs that is de-coupled from the for-profit sector, focused on what are appropriate reduced disclosures for users of PBE financial statements. It is also important that RDR disclosures are aligned across public sector entities and not for-profit entities for consistency and simplicity.

SMC 3: Do the PBE tier size criteria need to be revisited?

Q 10 Are you aware of any unintended consequences of the application of the PBE tier size criteria, or any recent developments in the reporting environment, which would suggest that the PBE tier size criteria need to be revisited?

Q 11 If you believe the PBE tier size criteria should be revisited, which of the four PBE tier size threshold do you think should be changed (noting the XRB limitations in amending PBE Tier 4, which is determined by the Government)?

Please provide reasons for your response, and any suggestions you may have for what the thresholds should be.

Q 12 Do you have any other comments on the tier size criteria for PBEs?

We agree that size criteria in the ASF should be reviewed at regular intervals. In our view, any change to the size criteria in the ASF needs to be carried out in conjunction with the statutory review of size criteria for reporting and assurance requirements. We consider it important to ensure that the tier structure is consistent across both for-profit entities and PBEs to avoid complexity and potential reporting arbitrage.

The current tier structure in the ASF together with legislative size criteria for financial statement preparation and assurance presents a complex picture. We encourage the XRB not to make any modifications to the ASF tier structure without considering the legislative framework for reporting and assurance.

We note that the Financial Reporting Act 2013 allows for the size criteria to be reviewed in 2022. We encourage the XRB to work with policy makers at the Ministry of Business, Innovation and Employment (MBIE) to promote a sensible and simpler legislative framework that takes into account any size criteria arising from the Charities Act review and requirements for reporting by incorporated societies.