CCEGIC, ca. 2011

OF COMMERCE

The Chair
CABINET ECONOMIC GROWTH AND INFRASTRUCTURE COMMITTEE

REVIEW OF FINANCIAL REPORTING FRAMEWORK: PRIMARY ISSUES

PROPOSAL

1 Following discussion at EGI in May 2011, I submit this revised paper. In this paper I am proposing revisions to the Financial Reporting Act 1993 (the FRA) and other legislation consistent with the principles and indicators of financial reporting. There is an accompanying secondary issues paper.

2 When EGI considered these papers in May I was invited to submit revised papers which include further consideration and advice on:

- a The implications of the proposals in relation to:
  - i Charities and other not-for-profit entities (Paragraphs 83-99)
  - ii The growth of small and medium companies (Paragraphs 35-37 and 159)
  - iii The requirements of creditors (Paragraphs 38-47 and 159)
- b The consequential work to be undertaken by the Inland Revenue Department, and the likely timeframes involved (Paragraphs 57-61)

TERMINOLOGY

3 The following terms, which are used throughout this paper, are defined and discussed in Appendix One:

- Generally accepted accounting practice (GAAP)
- General purpose financial reporting/reports (GPFR)
- Special purpose financial reporting/reports (SPFR)
- Accrual accounting and cash-in/cash-out accounting
- Reasonable and limited assurance (i.e. audit and review respectively)

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Recommendations and rationale

27 The preparation and audit requirements should be retained for the following reasons:

a The failure of a large non-issuer company can have significant adverse impacts on society. GPFR can contribute to avoiding business failure;

b There would be no noticeable compliance cost savings by removing the preparation requirement. Only a very small percentage of companies are large and the cost of filing is close to zero. In addition, most if not all large non-issuer companies would choose to prepare sophisticated financial statements for internal purposes even if they were not obliged to prepare GPFR; and

c The disadvantages associated with filing (i.e. loss of commercially confidential information and, for closely held companies, the loss of privacy) do not apply in relation to preparation and distribution.

Large companies that have 25% or more overseas ownership

The status quo

28 Large companies with 25% or more overseas ownership must prepare and file audited financial statements.

Recommendation and rationale

29 I recommend that the status quo be retained. GPFR are important for creditors of this class of company because of the difficulties of pursuing directors and shareholders in other jurisdictions in the event that the company fails.

Medium and small companies

The status quo

30 Medium-sized companies are required to prepare financial statements in accordance with the second tier of standards approved by the XRB (i.e. the Framework for Differential Reporting) or in accordance with the New Zealand standards that applied prior to the adoption of International Financial Reporting Standards (IFRS). This set of standards, which is commonly referred to as "Old GAAP" have not been maintained since 2002 and are out-of-date.

31 Small companies are also required to prepare but can do so in accordance with the simple format reporting requirements of the Financial Reporting Order 1994. The default in relation to assurance is that all companies must appoint an auditor, but opt out is available if the shareholders unanimously agree. The auditor must be a chartered accountant or an overseas-qualified person whose qualifications have been recognised by the Registrar of Companies. There is widespread non-compliance with the auditor appointment requirements among small companies. Most neither appoint an auditor nor put the required motion to a meeting of the company.