

**OFFICE OF THE MINISTER
OF COMMERCE**

The Chair
CABINET BUSINESS COMMITTEE

REVIEW OF THE FINANCIAL REPORTING ACT 1993

PROPOSAL

- 1 This paper proposes changes to the Financial Reporting Act (FRA) that would improve the workability of the financial reporting system and reduce business compliance costs.

EXECUTIVE SUMMARY

- 2 In 2002, the Accounting Standards Review Board (ASRB), which is an independent crown entity, decided to adopt International Financial Reporting Standards (IFRS) for periods commencing after 1 January 2007 for all New Zealand reporting entities, with an option of early adoption from 2005. Stakeholders pointed to three policy issues arising out of that decision.
- 3 First, it was considered that the institutional arrangements should be changed to reflect the greater future need to influence IFRS and to adopt them subject to any changes needed to reflect New Zealand circumstances (NZIFRS). In fact, it has been possible to do this effectively within the existing institutional framework.
- 4 Secondly, there was concern that the scheme of the FRA, which places considerable reliance on public-spiritedness by the accounting profession, would not be able to cope with the substantially increased workload. Subsequently, the Financial Reporting Standards Board (FRSB), which is a board of the New Zealand Institute of Chartered Accountants (NZICA), worked through the full set of 40 IFRS in detail and, by the end of 2004, the ASRB had approved a “stable platform” of NZIFRS. This achievement brought into question the earlier concerns that the existing framework was no longer appropriate. The standards bodies themselves are satisfied that the status quo is sustainable for now. Hence, wholesale reform is no longer regarded as a priority.
- 5 Thirdly, stakeholders were also concerned that the move to IFRS, which are designed for use by large companies, could adversely affect New Zealand’s sector-neutral standards. In fact, most of the benefits of sector-neutrality have been maintained in developing NZIFRS, but there is ongoing debate about the long term sustainability of this.

- 6 Although the main concerns from 2002 have proved to be manageable, a small number of changes should be made to the FRA as a matter of priority. Excessive financial statement preparation, audit and filing requirements imposed on some small companies and many overseas companies should be removed. In addition, it is very important to add an exemption-making power to the FRA before NZIFRS come into force on 1 January 2007 to deal with rare instances where full compliance would be impractical or unreasonable.
- 7 Some higher level issues need to be considered in the medium term. The main issue is whether there is a need for a single policy framework for standards-making. That would include consideration of whether making audit standards should continue to be approved by NZICA, or by a body that is independent of the profession. A closely-related issue is whether practitioners who audit private sector entities should continue to largely be regulated by NZICA. Decisions about whether the institutional framework should be retained or changed should be assessed in conjunction with the work on audit standards and auditor regulation.

BACKGROUND

The main principles underpinning financial reporting

- 8 Financial statements are aimed at providing an accurate picture of an entity's financial performance and position, allowing users to make informed decisions in relation to the entity. In particular, they provide investors with the information they need to decide whether to buy, sell or hold on to their investments, and provide a means for holding directors and senior management accountable for their performance. They also provide the board and senior management with the opportunity to take stock of the entity's performance and plan for the future.
- 9 The main principle underpinning requirements on some entities to publish their audited financial statements is public accountability. Under this principle, all entities that issue securities to the public are reporting entities and are required to file their audited annual financial statements with the Registrar of Companies (The Registrar). In addition, the central government, local governments and a range of bodies funded by governments ranging from regulators to schools are reporting entities because they spend public money obtained through the taxation system.
- 10 The public accountability principle is in the process of being extended to charities under the Charities Act 2005. From 2007, charities that wish to retain the tax exemption on their income will need to register with the Charities Commission. From 2008, they will need to attach their financial statements to the annual return filed with the Commission.

The financial reporting standards-setting framework

- 11 IFRS are made by the London-based International Accounting Standards Board (IASB). The IASB is committed to developing a single set of high quality, understandable and enforceable global accounting standards for use by large profit-seeking companies. About 100 countries have either adopted IFRS or are in the process of doing so¹. Notable exceptions are the United States and Japan. However, the IASB has convergence projects with both countries.
- 12 The New Zealand financial reporting framework is provided by the FRA together with 60-odd statutes that cross-refer to the FRA². Together they identify:
- a The entities that are required to produce financial reports; and
 - b The entities that are required to have those financial statements audited and made public.
- 13 The FRA constitutes the ASRB as an independent crown entity, and its main function is to approve financial reporting standards. Under the scheme of the FRA, the NZICA or any other organisation may submit draft standards to the ASRB for approval. In practice, the FRSB is the only body that does so. Approved standards have the force of law.
- 14 The New Zealand standards-setting process crucially relies on the willingness of the accountancy profession to make the major contribution. Members of the FRSB receive no remuneration. The analytical work in support of the FRSB is carried out by NZICA staff and contractors. The ASRB has no premises or staff, and administrative support services have been provided at discounted rates by all of the “Big Four” accounting firms at one time or another. The adoption of IFRS has also heightened the need for the ASRB and FRSB to liaise with the IASB. The ASRB has that role mainly at the oversight and strategy level, while the FRSB liaises mainly at the technical level.

The Financial Reporting Framework

- 15 There is a three-tiered structure for financial reporting in New Zealand. The top tier comprises issuers, entities that are funded by taxation, rates and levies and some large private companies. They must prepare financial statements in compliance with full New Zealand standards (i.e. NZIFRS from 2007 onwards). Most of the top tier entities must also have those statements audited and filed. The middle tier, called the Framework for Differential Reporting (FDR), provides exemptions from the full standards³ for certain medium-sized and small entities that do not have public accountability.

¹ Many countries are limiting the application of IFRS to listed companies. Only New Zealand and Australia are adopting or converging national generally accepted accounting practice with IFRS.

² The four most important are the Companies Act 1993, the Securities Act 1989, the Public Finance Act 1989 and the Local Government Act 2002.

³ For example, they do not need to produce cash flow statements and they can use taxation depreciation rates rather than rates that reflect the economic value of the assets.

The bottom tier, called the Exempt Companies System (ECS), applies only to small closely-held companies. ECS companies are only required to complete simple fill-in-the-box type forms, with no mandatory audit or filing requirements.

- 16 The FRA also requires all overseas-incorporated and owned companies to file audited financial statements, regardless of their size. In addition, all companies are required to keep proper accounting records, including a requirement that those records will at any time enable the financial position of the company to be determined with reasonable accuracy.
- 17 This reporting framework is fundamentally different to the two-tier system operating in Australia. Australia imposes reporting requirements on a wider range of entities than New Zealand. However, Australia does not impose preparation requirements on entities that are not reporting entities. The TransTasman Accounting Standards Advisory Group, which was established in early 2004 as a part of the Single Economic Market initiative, has decided to explore the opportunities for reducing or eliminating the differences. Work will commence in early 2006.

PROBLEM DEFINITION

- 18 The major reasons for commencing a review were concerns that, as a result of adopting IFRS:
- a The institutional arrangements could be substantially improved taking into account the new need to influence and take standards, in combination with the existing role of making standards; and
 - b The existing institutions were already operating at or near capacity and would struggle to cope with the increased workload.
- 19 In fact, the FRSB and ASRB have effectively managed the substantially increased workload to date and it appears that there is no need to change the institutional arrangements at present. However, the following risks will need to be managed in the medium term:
- a The consequences if the accounting profession's commitment or capacity to continue their involvement in standards-making at current levels were to diminish;
 - b A possible broadening of the responsibilities of the independent crown entity (ICE) at the apex of the New Zealand reporting system (i.e. the ASRB or a replacement body). The specific issues that need to be considered are:
 - i Whether the ICE should have a broad strategic and oversight role across all external reporting, covering such matters as making and approving audit and actuarial standards; and

- ii Whether the ICE should have a role in the regulation of auditors and, if so, what that role might be. Auditors are regulated wholly by NZICA. However, in recent years several overseas jurisdictions, including Australia, have introduced government regulation to either replace or complement self-regulation.
- 20 These issues do not need to be considered now and I have asked officials to report to me on problem definition and risk analysis issues next year. However, the following second level problems should be considered now with a view to enacting changes in 2006:
- a The qualifying criteria for the ECS are unnecessarily restrictive and, as a consequence, some entities are required to comply with the FDR system when the ECS would be sufficient. Therefore, I am proposing that the ECS thresholds be increased. The resulting compliance cost reductions would implement changes suggested by the Commerce Select Committee in 1998 and by the Ministerial Panel on Compliance Costs in 2001;
 - b Many overseas companies are subject to excessive reporting, and unnecessary audit and filing obligations. Changes should be made in 2006 because these requirements are harming the New Zealand part of the business of some of those companies. These requirements also draw Companies Office enforcement resources away from more serious forms of misconduct; and
 - c Full compliance with NZIFRS may be impractical or unreasonable for some reporting entities. The proposed solution is to provide the ASRB with limited powers to exempt entities from aspects of financial reporting requirements. It is very important that this power be added to the FRA before NZIFRS come into force from 1 January 2007.
- 21 The rest of this paper addresses these and some other changes that would improve the workability of the financial reporting system.

COMMENT

The Exempt Companies System

- 22 A company qualifies for the ECR if it meets all of the following conditions:
- a It must not be an issuer;
 - b It must not be an overseas company;
 - c Its total assets must not exceed \$450,000;
 - d Its turnover must not exceed \$1 million;
 - e It must not be a subsidiary; and
 - f It must not have any subsidiaries.

- 23 Qualifying companies do not have to comply with full New Zealand generally accepted accounting practice (NZ GAAP⁴) or the FDR. Instead, the FRA requires exempt companies to prepare financial statements in accordance with a simple standard format set out in the Financial Reporting Order 1994 (the 1994 Order).
- 24 The ECS has been criticised for the following reasons:
- a A fundamental questioning of whether small companies should be required to produce financial statements;
 - b The financial statements in the format required by the 1994 Order have little value for most potential users. Banks and other lending institutions do not use them. Nor do credit agencies, creditors or other potential users. Furthermore, they seem to be of little if any use to the companies themselves. However, the Inland Revenue Department (IRD) uses the ECS financial reports as the starting point for taxation assessments; and
 - c The thresholds appearing in paragraph 22 (c) and (d) are too low. Many companies that are ineligible for the ECS are closely-held and/or are too small to have any use for the more sophisticated financial reports required by the FDR.
- 25 Further work should be carried out before decisions are made on whether entities that qualify for the ECS should continue to have preparation requirements. This will include consideration of IRD's information needs and the Australian situation. This work can be completed in 2006 in parallel with the work on audit standards and auditor regulation. However, the following changes should be made to the ECS as soon as possible:
- a To align the method for ECS qualification with the method used under the FDR. That approach is a two-out-of-three criterion based on total assets, annual turnover and numbers of full time equivalent employees. This approach reduces the risks that too few companies within a particular industry type (e.g. labour-intensive industries) will be unable to obtain the benefits of the ECS;
 - b To increase the number of companies qualifying for the ECS by adopting the following thresholds for the two-out-of-three criterion:
 - i Total assets of less than \$1 million;
 - ii Annual turnover of less than \$2 million;
 - iii Five or fewer full-time equivalent employees; and
 - c To allow the thresholds to be changed by Order-in-Council. Thresholds tend to become out of date after some time and this would allow the thresholds to be increased without using parliamentary time.

⁴ In essence, NZ IFRS will become NZ GAAP from 2007.

- 26 Although data are not available in relation to the asset and turnover amounts, Ministry of Economic Development (MED) data indicate that around 87% of enterprises have five or fewer employees. Although this figure includes all forms of businesses, it is evident that the bulk of companies would qualify for the expanded ECS.

Framework for Differential Reporting

- 27 There are no issues in relation to the FDR. Unlike the ECS, the FRA includes no references to the FDR. The FDR is a financial reporting standard that was developed by the FRSB and approved by the ASRB.
- 28 An entity does not qualify for the FDR if, in broad terms, it has recently stopped becoming an issuer, has the coercive power to tax or there is separation between the owners and the governing body of the entity. In addition, it must comply with two of the following three thresholds:
- a Total assets of less than \$10 million;
 - b Annual turnover of less than \$20 million; and
 - c 50 or fewer full-time equivalent employees.

Overseas Company Reporting

- 29 All overseas companies carrying on business in New Zealand are required to file audited financial statements in accordance with NZ GAAP regardless of size. This means that overseas companies have significantly greater obligations under the FRA than New Zealand companies. There is a reason for this. New Zealand users have an interest in the financial performance and position of the overseas company itself, the New Zealand part of the business and, where relevant, the group of companies. For example, IRD uses overseas company financial statements to determine whether the companies are paying an appropriate amount of tax. Nevertheless, the FRA requirements are complex, difficult to understand and excessive in some respects. There are three sets of problems, which are discussed below.

Overseas-incorporated companies which have New Zealand branches

- 30 Overseas-incorporated companies must prepare, have audited and file financial statements as follows:
- a The New Zealand branch as though it were a stand-alone legal entity;
 - b In some circumstances, group financial statements for the New Zealand operations of the overseas company. This requirement will arise if, for example, the overseas company has a New Zealand branch and a New Zealand-incorporated subsidiary;

- c The separate financial statements of the overseas company; and
- d In some circumstances, the group financial statements of the overseas company.
- 31 In cases (a) and (b) the financial statements must be prepared and filed in accordance with NZ GAAP, and be audited and filed. In cases (c) and (d), they are usually required to be prepared in accordance with NZ GAAP and filed. However, the Registrar can accept statements prepared in accordance with requirements that are “substantially the same” as NZ GAAP. The audit report must also be filed where the financial statements are required to be audited in the company’s home country.
- 32 These requirements are appropriate most of the time. However, problems can occur depending on the individual circumstances. An example of the type of problem that can occur relates to the “substantially the same” test. That test is narrow and requires some companies to needlessly reformulate the financial statements in accordance with NZ GAAP. This requirement is justified where the country of incorporation has substandard corporate governance laws and/or accounting standards. However, it also requires companies incorporated in some jurisdictions with sound corporate governance systems and reporting standards (e.g. Japan) to reformulate their financial statements.
- 33 There is no simple way of amending the FRA to deal with this problem because the appropriate level of reporting depends on the specific circumstances. Therefore, I am proposing that the ASRB be empowered to make class and individual exemptions where compliance would be unnecessary or impractical. That power would need to be carefully crafted to make it clear that:
- Exemptions will only be granted where the case for doing so is strong; and
 - The exemptions would be no greater than is needed to deal with the specific issue in question. This is essential because wholesale optional exemptions would derogate from the reasons New Zealand adopted IFRS.
- 34 In addition, the ASRB would need to consult other government agencies before exercising the exemption powers. Consultation with the Inland Revenue Department would always be required. Other agencies, such as the Securities Commission, the Office of the Controller and Auditor-General and the Reserve Bank, may need to be consulted depending on the circumstances.

Subsidiaries of overseas companies

- 35 The FRA requires subsidiaries of overseas companies to prepare, have audited and file financial statements that comply with NZ GAAP. A problem arises because the definition of “subsidiary” includes a subsidiary of a subsidiary, which means that each and every subsidiary within a group ultimately controlled by an overseas parent is captured. The all-encompassing requirements for overseas subsidiaries mean that even dormant subsidiaries within overseas-controlled groups must have their financial statements audited and filed.

- 36 A solution would be to limit the requirement for audit and filing to the top New Zealand company and its group. However, this is impractical. The overseas reporting requirements in the FRA are convoluted and intricately mixed with the reporting requirements for domestic companies. It would require a major rewrite of one part of the FRA. A better solution would be to make the exemption system outlined in paragraphs 33 and 34 available for this type of overseas company audit and filing problem.

Overseas-owned companies

- 37 The FRA states that a company is overseas-owned if overseas-incorporated companies and/or overseas-resident persons are entitled to exercise 25 percent or more of the voting power. This rule is problematic. To illustrate, consider a small ECS-qualified New Zealand-owned company with the voting shares owned in equal amounts by four siblings. It would become an overseas-owned company if one member of the family migrated to Australia. This, in turn, would mean that the company no longer qualifies for the ECS and instead would be required to comply with the differential reporting system and file their financial statements.
- 38 Although this is an extreme example, it demonstrates that overseas ownership *per se* does not establish a case for additional reporting requirements. However, unlike the other overseas companies matters covered in this paper, there has been no public consultation on whether these requirements should be retained for large overseas-owned companies. Consultation would be appropriate before a decision is made. In conclusion, I am proposing:
- a Removal of the additional preparation, audit and reporting requirements for overseas-owned companies that would otherwise qualify for the ECS or the FDR;
 - b Inclusion of an anti-avoidance measure to prevent larger companies from avoiding this change by, for example, splitting the New Zealand operations among two or more subsidiaries of the overseas company; and
 - c That a decision on large overseas-owned companies not be made until after there has been consultation with interested parties.

Other issues

Other exemption issues

- 39 The proposed exemption-making powers will also need to deal with any aspects of IFRS that may not be fully applicable to New Zealand circumstances before entities are required to produce their first sets of NZIFRS-based financial reports from 1 January 2007 onwards. For example, one IFRS requires redeemable shareholders' funds to be treated as liabilities rather than equity. This treatment may be inappropriate for co-operative companies and trusts.

Conduit issuers

- 40 The Securities Commission has identified a problem in relation to entities that raise money through an issue of securities to the public and pass on all or a substantial part of the funds to a related entity that is not an issuer. The transferee entity does not have to file audited financial statements. This means that investors do not obtain the information they need to evaluate the financial performance and position of the entity that they have, in a real sense, invested in. This is not a widespread problem. However, the reporting requirements should reflect substance not form. The entity that receives and uses the funds should be treated as if it were an issuer.

Group financial statements

- 41 The Securities Commission has also identified an issue in relation to group financial statements. The FRA states that audited group financial statements are not required to be prepared and filed by issuers in certain circumstances. This is intended to exempt multi-tiered corporate group structures from having to prepare group financial reports for wholly-owned subsidiaries. However, that exemption applies even if one or more of the subsidiaries are issuers in their own right. This is inconsistent with the purpose of the FRA and should be corrected.

Distribution of financial reports to shareholders

- 42 The Companies Act requires companies to send financial reports prepared under the FRA to all shareholders, even those electing not to receive other annual documentation. The Electronic Transactions Act 2002 allows the company to send them electronically provided shareholders agree in advance. However, it is sometimes easier for companies with large numbers of shareholders to send a printed version by mail than to obtain advance consent for an electronic version to be sent.
- 43 I am proposing that the compliance problem be solved by implementing both of the following changes. First, shareholders should be given the option of being sent concise annual reports. This would provide shareholders with the ability to obtain the information in whichever form better suited their needs. Secondly, the Companies Act should be amended to merely require the company to notify shareholders of the availability of company reports rather than send the reports automatically. Shareholders would then be able to download the report from the company's website or request a hard copy.
- 44 The Securities Commission considers that the second proposal would reduce the likelihood of shareholders receiving financial reports because some will not take the active measure required to obtain a copy. An alternative perspective is that electronic technology provides ready access to annual reports. Hence, the accountability and transparency objectives of financial reporting will not be compromised by this change.

Non-active entities

- 45 Some entities which do not have any transactions in the course of a financial year have preparation and, in some cases, filing requirements. These requirements serve no purpose. I am proposing therefore, that the FRA be amended to exempt non-active companies from all preparation requirements if two directors (or one if the company only has one director) sign and file a statement with the Registrar stating that the company did not trade during the course of the financial year.

Enforcement in relation to non-compliance with filing requirements

- 46 It is an offence to fail to file financial statements by the required date. The FRA provides for a maximum fine of \$100,000 per company director on summary conviction. There are no other formal enforcement mechanisms, which is a problem for the Registrar. Sometimes the offending will not be serious enough to warrant criminal prosecution. Furthermore, criminal prosecution is time-consuming and the Registrar's priority lies with more serious misconduct, such as reckless trading. The problem could be resolved if the Registrar had the power to issue infringement notices incorporating an infringement fee for late filing. A fee of \$7,000 would be appropriate given the maximum criminal penalty for this offence on summary conviction, the level of fine being imposed by the courts in relation to this offence, and infringement fee levels under other commercial laws. Criminal prosecution and sanctions would remain available for serious or persistent offending.

Registered charities

- 47 One of the MED discussion documents proposed bringing charities registered under the Charities Act 2005 within the ambit of the FRA. The reason for this is that the scheme of the Charities Act includes an annual reporting component which is likely to start operating from 2008 onwards. Having a set of standards that apply to registered charities would provide certainty that the financial statements attached to the annual return have been prepared in a sound fashion and on a consistent basis.
- 48 While this is an important medium term objective, there is no urgency. Including measures on charities in the proposed amending legislation would attract the attention of the large and diverse charities sector and could slow the legislative progress, especially the select committee process. In addition, regulations made under the Charities Act could, in broad terms, specify the reporting requirements for larger charities. Furthermore, NZICA has recently established a working group which has the objective of ensuring that current reporting requirements for public benefit entities, including charities, continue to be appropriate. I have asked officials to report back to me on the issue of financial reporting by registered charities by November 2006.

CONSULTATION

- 49 There has been consultation with the Ministry of Justice, Treasury, Inland Revenue Department, New Zealand Customs Service, Department of Internal Affairs, Ministry for the Environment, Statistics New Zealand, Department of Prime Minister and Cabinet, Office of the Auditor General, State Services Commission, Accounting Standards Review Board, Companies Office, Reserve Bank, Securities Commission, New Zealand Institute of Chartered Accountants, the Financial Reporting Standards Board and the Charities Commission.
- 50 In addition, this paper has been informed by responses to three discussion documents. The first, released in 2002, was on the ECS. The subsequent two, released in 2004, were on the Financial Reporting Act.

Summary of submissions

- 51 172 submissions were received on the final, comprehensive discussion document from a range of entities, including public and private companies, government agencies, legal and accountancy firms, representative bodies, academics, private individuals, and the not-for-profit sector.
- 52 Comments were made on a range of issues that I am not making recommendations on at present, such as institutional arrangements and the financial reporting framework. Of the issues covered in this paper, there was broad support for reducing the compliance burden on small companies and overseas-incorporated companies.
- 53 In relation to auditors and auditing standards, there was a common theme that New Zealand does not have any issues in the audit profession that require immediate or urgent reform. Some submitters also noted the international trend to remove or reduce the level of self-regulation and expressed a desire that New Zealand move in this direction. Others see no need for change.

FISCAL IMPLICATIONS

- 54 The proposed exemption system will impose some extra costs on the ASRB. However, the increase is not expected to be large because few exemptions are likely to be granted. The benefits of an exemption will accrue to the applicant and in these circumstances it is usual for the applicant to be charged for the cost. For example, the Securities Commission is empowered to charge an administration fee and an hourly charge out rate to applicants for exemptions to securities law. Therefore, I am recommending that a regulation-making power be added to the FRA.
- 55 Last year the Registrar received 9,600 financial reports. The proposed changes to overseas company reporting could reduce the number of filings to about 4,100. This would mean a 140% increase in the fixed cost per filing. Although staffing costs would fall by about one third, this represents less than 10% of the total cost of the system. Hence, the filing fee for financial statements, which is currently \$100, would need to be roughly doubled to meet the shortfall.

- 56 Two other fiscal issues will need to be considered in the medium term with or without change to the institutional arrangements and reporting framework:
- Whether it remains appropriate for the cost of the financial reporting system to be borne by the accounting profession and companies. A considerable number of central and local government and other public benefit entities are subject to NZIFRS. This brings into question whether the system is fair; and
 - The ASRB is funded from a memorandum account that was accumulated through surpluses from Companies Office fees. That account will, in all probability, run out some time during 2008/09. Hence, it will be necessary to consider further increases to Companies Office fees, alternative sources of funding or a combination of the two.
- 57 The medium term fiscal implications would vary significantly depending on what might be decided in relation to auditing and institutional arrangements. The increased government funding sought could range from \$400,000 to \$2.5 million. The relevant amount would be sought as a part of the normal budget cycle next year or the year after.

HUMAN RIGHTS

- 58 At this stage, the proposals outlined in this paper appear to be consistent with the rights and freedoms affirmed in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993. A final view will be possible once the relevant legislation is drafted.

LEGISLATIVE IMPLICATIONS

- 59 It will be necessary to make a small number of amendments to the FRA and the Companies Act. I am proposing that these changes be included in a Business Law Reform Bill to be introduced and enacted in 2006. Early enactment is necessary because the exemption-making powers need to be in place before NZIFRS come into force on 1 January 2007.
- 60 The Bill would also include Friendly Societies and Credit Unions Act changes that have already been approved by Cabinet. In addition, I am planning to submit a paper to Cabinet early in 2006 suggesting two changes to the Companies Act that would promote Australia-New Zealand Single Economic Market objectives.

REGULATORY IMPACT AND COMPLIANCE COST STATEMENT

- 61 Regulatory impact and business cost compliance statements are attached which comply with the requirements as set out in Cabinet Office Circular CO (04) 4. Based on the information provided in the attached RIS/BCCS, the regulatory Impact Analysis Unit considers that the disclosure of information is adequate, and the level of analysis is appropriate given the likely impacts of the proposal.

- 62 The proposals in relation to the exempt companies system, overseas companies, non-active entities, exemptions and annual reports will all reduce business compliance costs (BCC). The proposals in relation to conduit issuers and subsidiary companies that are issuers in their own right will increase BCC for a very small number of entities. Overall, the package of measures described in this paper will reduce BCC.

PUBLICITY

- 63 I will make a public announcement following cabinet decisions. MED officials will place the RIS/BCCS and other information on its website, include an item in its electronic news bulletin, and write to all submitters informing them of the decisions. NZICA will also include articles in its monthly publication, *The Chartered Accountants Journal*.

RECOMMENDATIONS

- 64 I recommend that the Committee:
- 1 **Note** that officials will report on problem definition and risk analysis issues to the Minister of Commerce on the following issues by 30 November 2006:
 - 1.1 The framework for making and approving audit standards;
 - 1.2 The regulation of auditors;
 - 1.3 The implications of these and other outstanding issues for the financial reporting framework and institutional structures;
 - 2 **Note** that:
 - 2.1 There are significant differences between the New Zealand and Australian financial reporting frameworks;
 - 2.2 The TransTasman Accounting Standards Advisory Group will commence work to explore the opportunities for reducing or eliminating those differences;
 - 2.3 A date for completing this work is yet to be determined;
 - 2.4 This work could lead to further legislation;
 - 2.5 None of the other recommendations prejudice the outcome of this work;
 - 3 **Agree** to amend the Exempt Companies System in the following ways:
 - 3.1 Establish a two-out-of-three eligibility criterion as follows:
 - 3.1.1 Total assets of less than \$1 million;

- 3.1.2 Annual turnover of less than \$2 million;
- 3.1.3 Five or fewer full-time equivalent employees;
- 3.2 Allow the thresholds to be changed by Order-in-Council;
- 4 **Note** that officials will report to the Minister of Commerce by 30 November 2006 on whether exempt companies should continue to be required to prepare financial statements;
- 5 **Agree** to empower the Accounting Standards Review Board to grant exemptions from specific requirements of the Financial Reporting Act where compliance would be unreasonable or impractical;
- 6 **Agree** that the Accounting Standards Review Board shall have regard to the views of other relevant government agencies before making exemption decisions;
- 7 **Agree** to add a regulation making power that will allow the Accounting Standards Review Board to charge fees in relation to exemption applications;
- 8 **Agree** to the following in relation to overseas companies:
 - 8.1 Maintain the substantive reporting requirements for overseas-incorporated companies;
 - 8.2 Provide scope for relief from the overseas-incorporated companies reporting requirements through the exemption-making powers proposed for the Accounting Standards Review Board in point 5 above;
 - 8.3 Remove the requirements on overseas-owned companies to file audited financial statements if they qualify for the differential reporting or exempt companies systems;
- 9 **Note** that officials will report to the Minister of Commerce on the application of the Financial Reporting Act to large overseas-owned companies by 30 November 2006;
- 10 **Agree** that entities which receive money through an issue of securities to the public through conduit issuers will be required to comply with financial reporting requirements as though they were issuers;
- 11 **Agree** that wholly-owned subsidiaries of issuers that are issuers in their own right be required to file audited group financial statements that comply with New Zealand International Financial Reporting Standards;
- 12 **Agree** that, as an alternative to sending annual reports to all shareholders, companies will have the option of notifying shareholders of the availability of annual reports in hard copy or electronic form;

- 13 **Agree** that companies will be able to offer shareholders either the full or a concise annual report;
- 14 **Agree** to introduce an infringement notice system for failure to file financial statements with the Registrar of Companies by the due date;
- 15 **Agree** that the fee associated with the infringement notice will be \$7,000 for each director of the company;
- 16 **Agree** that entities should not have any requirements to prepare financial statements, subject to filing a statement with the Registrar of Companies that the entity has not been involved in any transactions during the course of the financial year;
- 17 **Note** that officials will report to the Minister of Commerce on financial reporting by charities registered under the Charities Act 2005 by 30 November 2006;
- 18 **Agree** that the changes proposed above will be included in a Business Law Reform Bill;
- 19 **Note** that the changes should be enacted in the second half of 2006; and
- 20 **Note** that this paper will be placed on the Ministry of Economic Development website.

Hon Lianne Dalziel
Minister of Commerce