BusinessNZ
The voice of business

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Financial reporting
C/- Deputy Commissioner
Policy and Strategy Division
Inland Revenue Department
PO Box 2198
WELLINGTON 6140

Dear Sir/Madam

Re: Minimum financial reporting requirements for companies

I am writing to you regarding the IRD issues paper *'Minimum financial reporting requirements for companies,* released in November 2013 (referred to as 'the paper').

The following comments outline both our overarching views on the paper, and specific issues we believe IRD needs to address.

Background

While the Financial Reporting Bill currently before Parliament would remove the requirement for small and medium enterprises (SMEs) to prepare general purpose financial statements, SMEs will still have to prepare special purpose financial statements for tax purposes. Therefore, ensuring that IRD is correct in mandating the minimum requirements for such entities is important, if there is to be a proper balance between an appropriate level of compliance for business and statements that would satisfy the department's information demands.

General view

Overall, we are supportive of the moves by IRD to consult on minimum requirements for special purpose financial statements. This will help to give taxpayers and their advisers greater certainty about what IRD will expect to see in financial statements.

Given the minimum standards required are expressly for the purpose of allowing IRD to access compliance with the tax rules, we believe the paper is upfront about any illusions that the is about setting itself up as an arbiter of accounting standards.

Obviously, an underlying issue that submitters need to be aware of is the work the New Zealand Institute of Charted Accountants (NZICA) is currently consulting on in regard new special purpose financial reporting standards for SMEs. Paragraph 3.10

states that *"it has yet to be determined exactly how this framework will match with the minimum requirements that IRD is contemplating",* and we would agree with the statement in the next paragraph that *"it seems very likely that if financial statements are prepared in accordance with NZICA's SME framework, they will exceed Inland Revenue's minimum requirements"*. Therefore, it is important for IRD to be mindful of the possible framework NZICA will release so that its own requirements do not inadvertently end up being higher.

Compliance cost implications

Paragraph 1.6 of the paper outlines the issue of compliance costs, and in certain respects has a bet each way in terms of the overall impact on businesses. The paper states that it anticipates a fall in compliance costs given the broader removal of general-purpose requirements as part of the wider company financial reforms. However, only medium-sized companies are likely to enjoy the decrease, while other companies that currently prepare financial statements are not likely to be significantly affected. Of course, the paragraph does not mention other companies that will be brought into the new requirements that may see an increase in compliance.

As others have recently mentioned post the release of the paper, there is a risk that one set of compliance costs could simply be replaced with another. Therefore, we are not convinced that the overall level of compliance will fall for the business community, and in fact may increase.

We appreciate that compliance costs are one of a number of factors that IRD needs to consider when looking to introduce changes to tax policy. In addition, we strongly endorse the statement made in paragraph 1.6 that *'compliance costs are a major consideration'*. However, we believe that the compliance cost aspect should be given a large degree of weight when final decisions are made. As we have outlined in previous submissions, compliance costs are often cumulative in their outcomes, which means even small changes in process can ultimately lead to a sizeable lift in compliance obligations for business.

Recommendation: That compliance costs implications are given a higher weighting regarding any future decisions made by IRD.

ASC and capital gains

As the minimum requirements list in the appendix outlines, new aspects to reporting will include formalising the requirement to track Available Subscribed Capital (ASC), as well as realised capital gains.

Although BusinessNZ understands the need for including such requirements, we believe these will create issues for a large number of businesses that have never recorded/tracked such items. Therefore, it may take a considerable amount of resources to recreate historical balances for those businesses that have been trading for some time.

In view of the difficult issues that might arise, we believe IRD needs to ensure it takes a more pragmatic approach to compliance requirements. Therefore, we would support moves for an extension of time for the introduction of ASC and capital gains tracking requirements so affected enterprises are able to provide accurate information.

Recommendation: That IRD takes a pragmatic approach to setting timelines for requiring businesses to track available subscribed capital, as well as realised capital gains.

Non-corporate business that could prepare financial statements

BusinessNZ welcomes the opportunity IRD is taking to ask for public comments about the indicative thresholds for preparing special purpose financial statements for non-corporates, such as sole traders and partnerships. While any changes will not occur until April 2015, it is certainly advisable to start thinking about this issue sooner rather than later.

Paragraph 4.2 points out that *'except at the margin, we believe that most of these taxpayers are presently preparing financial statements and so there should be minimal compliance costs involved'*. However, the paper then goes on to point out that *'we acknowledge that this is dependent on the selection of an appropriate threshold'.* In relation to this statement, the second bullet point of paragraph 4.1 suggests that the minimum threshold for these types of entities could be the GST registration threshold of $60,000 (turnover or expenses, but ignoring sales or purchases of capital assets and other balance sheet transactions). The paper points out that this threshold would exclude around 40% of the 550,000 active IR10 filers.

We are not against the idea of using GST thresholds as a test for whether the standard is met. However, in this instance BusinessNZ believes the minimum threshold needs to be set somewhat higher, primarily because of what we view many non-corporates to be. In this context, we agree with the statement in the paper that *"the minimum threshold for these other businesses should be such that micro-businesses should have no financial reporting obligations"*.

As an example, if we were to take a one-person home-based business involved in importing goods from offshore and selling them via an existing site like Trademe, an average turnover of $5,000 per month will equate to meeting the threshold for GST and will be not out of sight for many, especially if threshold limits are not changed over time to keep in line with inflation.

As a further example, there would be a sizeable number of directors on boards who would be receiving more than $60,000 in frees over a year. It would not seem logical from our perspective for them to have to meet the requirements of the additional financial reporting requirements on this basis alone.

Consequently, we would rather there was a significantly higher threshold value and therefore a greater ability to distinguish between the smaller end of SMEs and those that in all likelihood should comply with the new requirements. We believe the threshold would be better set at $150,000 or more to ensure a clear and pragmatic gap between those non-corporate enterprises that should, and those that should not, have to complete special purpose financial statements for tax purposes.

Recommendation: That if a GST threshold is to be used for non-corporates in relation to preparing financial statements, it should be set to at least $150,000.

Thank you for the opportunity to comment, and we look forward to further developments on this matter.

Kind regards,

Phil O'Reilly
Chief Executive
BusinessNZ