



29 August 2019

Inquiry Director  
Local Government Funding and Financing  
New Zealand Productivity Commission  
PO Box 8036 The Terrace  
WELLINGTON 6143  
New Zealand

**Email:** info@productivity.govt.nz

Attention: Steven Bailey

Dear Steven

***Local Government Funding and Financing – Draft report***

**Introduction**

1. The External Reporting Board (XRB) is pleased to have the opportunity to comment on the New Zealand Productivity Commission's *Local Government Funding and Financing – Draft Report* (Draft Report). We have responded to selected recommendations in the Draft Report as our interest and mandate is limited to financial and non-financial reporting.
2. We acknowledge the significant effort that has gone into the Productivity Commission's comprehensive draft report on local government funding and financing in New Zealand.
3. Our submission is structured as follows:
  - (a) XRB's role, responsibilities and focus;
  - (b) XRB's recommendations;
  - (c) Comments on selected recommendations from the Draft Report.
    - (i) Local Government reporting requirements – Recommendation 5.4; and
    - (ii) Mandatory Audit and Risk Committee – Recommendation 5.3; and
  - (d) Conclusion.

### **XRB's role, responsibilities and focus**

4. The XRB is an independent Crown Entity responsible for financial reporting strategy and the development and issue of accounting, and auditing and assurance, standards in New Zealand.
5. New Zealand Government legislation determines **who** is required to report, for example, public sector entities. The XRB is responsible for **what** these entities are required to report, being XRB standards.
6. Under the Financial Reporting Act 2013, the XRB issues accounting standards for all entities that are required, or opt, under law to prepare financial statements that comply with generally accepted accounting practice (GAAP). From 1 July 2014, XRB accounting standards were required to be applied by all Tier 1 and Tier 2 public sector public benefit entities.
7. In issuing its standards, the XRB focuses on users' needs for information in general purpose financial reports (GPFR), that is, information intended to meet the needs of users who are not able to require an entity to prepare reports tailored to their particular information needs. For local government, these users are resource providers — including ratepayers, taxpayers and lenders – and service recipients. The XRB undertakes various activities to ensure that we continue to set standards that meet the general purpose needs of users of financial reports, including undertaking due process consultation (as required under section 22 of the Financial Reporting Act 2013) and carrying out user-needs research.
8. The Financial Reporting Act 2013, section 17, clarifies that the XRB may issue financial reporting standards on non-financial reporting. Section 17(1) provides for the XRB to issue standards in relation to reporting on an entity's performance, an entity's related party transactions and any other non-financial matter that directly relates to or is incidental or ancillary to financial reporting.

### **XRB's recommendations**

9. The XRB recommends that:
  - (a) A working group undertake a review of the interaction between financial and non-financial reporting requirements under GAAP and other requirements under local government legislation;
  - (b) The XRB standard written specifically for public benefit entities, PBE FRS 48 *Service Performance Reporting*, be considered as a starting point for developing a framework for local authority reporting on performance;
  - (c) Extended External Reporting (EER) be considered as part of the review to facilitate local authority reporting better satisfying user-needs; and
  - (d) Audit and risk committees become mandatory for local authorities.

## **Comments on selected recommendations from the Draft Report**

10. Our comments are focused on Chapter 5 *Improving decision making* as it relates to financial and non-financial reporting.

### **(i) Local Government reporting requirements – Recommendation 5.4**

11. Section 8 of the Financial Reporting Act 2013 states that financial statements, reports or other information complies with GAAP only if the reports or financial statements or other information complies with applicable financial reporting standards (or in the absence of an applicable financial reporting standard, an authoritative notice).
12. Standards issued by the XRB apply to all entities (across the for-profit entity, public sector entity and not-for-profit entity sectors) who have a legislative requirement, or opt to, prepare GPFR that comply with XRB’s standards.
13. XRB A1 defines public sector public benefit entities (public sector PBEs) as PBEs that are public entities as defined in the Public Audit Act 2001, and all Offices of Parliament. Most PBE Standards deal with “traditional” financial reporting, being information about an entity’s revenues, expenses, assets, liabilities and equity, which is presented in an entity’s annual financial statements (included in the Annual Report).<sup>1</sup> However, in November 2017, the XRB issued a new Tier 1 and Tier 2 PBE Standard, PBE FRS 48 *Service Performance Reporting*. This standard becomes effective for annual financial reports covering periods beginning on or after 1 January 2021. Its objective is to establish principles and requirements for an entity to present service performance information that is useful for accountability and decision-making purposes. It requires, amongst other things, entities to disclose:
  - (a) sufficient contextual information to understand why an entity exists, what it intends to achieve in broad terms over the medium to long term, and how it goes about this; and
  - (b) information about what the entity has done during the reporting period in working towards these broader aims and objectives.
14. The scope of PBE FRS 48 in relation to public sector PBEs is outlined in paragraph 3(b), as follows:

*Tier 1 and Tier 2 public sector PBEs required by legislation to provide information in respect of service performance in accordance with generally accepted accounting practice (GAAP). If an entity is required by legislation to report service performance information on only some of its activities, PBE FRS 48 applies only to those activities.*

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<sup>1</sup> There are also PBE Standards dealing with interim financial statements and prospective financial statements (e.g. prospective financial statements included a local authority’s long-term plan).

15. The Local Government Act 2002 covers the financial reporting requirements for local government. Section 111 states that certain information required by the Act must be prepared in accordance with GAAP:
  - (1) *All information that is required by any provision of this Part or of Schedule 10 to be included in any plan, report, or other document must be prepared in accordance with generally accepted accounting practice if that information is of a form or nature for which generally accepted accounting practice has developed standards.*
  - (2) *Subsection (1) does not apply to the preparation of a funding impact statement.*
16. The Funding Impact Statement is a mandatory requirement for local government under Section 20 of the Local Government Act 2002.
17. Additional information is required by the Local Government Act 2002 outside GAAP, such as reporting on groups of activities,<sup>2</sup> and rating base disclosures.
18. The Local Government (Financial Reporting and Prudence) Regulations 2014 requires reporting of financial prudence benchmarks e.g. the rates affordability benchmark.
19. The *Non-Financial Performance Measures Rules 2013* developed by the Department of Internal Affairs (DIA) specify performance measures that local authorities are required to disclose in their long-term plans and annual reports. These cover the water supply, sewerage and roading. An example is the measure for the safety of drinking water.
20. Consequently, the reporting for local government is required under two arms:
  - (a) Information that must be prepared in accordance with GAAP, which for most public sector PBEs means compliance with PBE Standards for the public sector (including service performance reporting under PBE FRS 48, when effective); and
  - (b) Other information required under local government legislation, which includes:
    - (i) The Funding Impact Statement;
    - (ii) Additional disclosures required under the Local Government Act 2002 outside GAAP;
    - (iii) Disclosures required under the Local Government (Financial Reporting and Prudence) Regulations 2014; and
    - (iv) *Non-Financial Performance Measures Rules 2013* (DIA).
21. The first principles review of “financial disclosures of low value to users of financial statements”, as per the first element of Recommendation 5.4 of the Draft Report, could only cover the reporting requirements other than GAAP. GAAP is mandated by law, and it is not possible for Local Government entities to “cherry pick” the financial disclosures

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<sup>2</sup> The PBE Standards do not contain a standard on Segment Reporting.

which they deem to be of “low value” to users. On developing the initial suite of PBE Standards, the XRB consulted widely with public sector and not-for-profit groups considering user needs and the cost benefit of the financial statements required, and the individual disclosures therein. However, there may be a need for additional principles-based guidance (or greater use of guidance that already exists) to assist entities to consider whether to remove excessively detailed information that could be immaterial.<sup>3</sup>

22. Also, a review that would “examine the mix of financial and non-financial disclosures”, as per the second element of Recommendation 5.4 of the Draft Report, could consider the interaction between GAAP reporting requirements and other reporting requirements. In particular, if a review occurs, we recommend the application of PBE FRS 48 be considered as a starting point for developing a framework for local authority reporting on performance to replace the current cross-agency requirements. This would improve the quality of reporting and minimise the repetition of disclosures.

#### Extended External Reporting

23. We encourage the working group to consider wider forms of reporting which we describe as Extended External Reporting (EER) and cover both financial and non-financial disclosures – which overlap with, but are broader than, the disclosures required under GAAP (including PBE FRS 48). We have a comprehensive section of the XRB website devoted to EER and encourage local government to consider the information we provide on this topic: <https://www.xrb.govt.nz/extended-external-reporting/>.
24. In particular, we note the broader coverage EER offers for emerging issues, and the ability to report beyond the current reporting year. This sits well with local government requirements for longer-term documents such as Long-Term Plans. It also provides an opportunity for reporting on environmental, economic and social sustainability risk and other key risks.
25. As mentioned in Recommendation 5.4, consideration would be given to Integrated Reporting <IR>. <IR> is one example of EER; a broader form of external reporting. We also note the six capitals of <IR>. Financial capital is synonymous with current financial reporting covered by GAAP (excluding the requirements of PBE FRS 48 which fall under the other capitals).
26. Furthermore, the four aspects of community well-being, being social, economic, environmental and cultural, were reinstated into the Local Government Act 2002 in the Local Government (Community Well-being) Amendment Bill in 2019 and align well with the multi-capital approach of <IR>.

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<sup>3</sup> PBE Standards include a pervasive concept of materiality, whereby a particular entity might not need to provide a specific disclosure if the information is not material to users of that entity’s financial statements.

### Working Group

27. We support the development of a working group for a review of local government reporting, but do not consider that a “first principles review” of disclosures required by GAAP is appropriate. As explained above, the application of XRB accounting standards, as required by legislation, is neither a selective nor an optional process. The accounting standards are mandated by law, and changes to the requirements would require legislative change which would be preceded by extensive consultation. However, we would support a review that considers the interaction between GAAP reporting requirements and non-GAAP reporting requirements (including PBE FRS 48), as discussed earlier. Also, development of principle-based guidance specific to local government entities, as suggested by Professor Ian Ball in his report,<sup>4</sup> is a possible avenue of improvement to ensure that the requirements for reporting for local government continue to be fit for purpose. We also advocate for investigation into EER.

### **(ii) Mandatory Audit and Risk Committee – Recommendation 5.3**

28. We encourage a focus on stronger governance in local government and so support an amendment to the Local Government Act 2002 to require all local authorities to have an Audit and Risk Committee.

### **Conclusion**

29. The XRB is keen to continue discussions with the Productivity Commission on its work on local government reporting.
30. If you have any queries or require clarification on any matters in this submission, please contact Judith Pinny ([judith.pinny@xrb.govt.nz](mailto:judith.pinny@xrb.govt.nz)) or me.

Yours sincerely



Michele Embling  
Chair  
External Reporting Board

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<sup>4</sup> Page 5, *Local Government Funding and Finance – Accounting and Financial Management Issues: Report to the New Zealand Productivity Commission* by Ian Ball, 2019, 44pp.