



**OFFICE OF THE
CONTROLLER AND AUDITOR-GENERAL**

Te Mana Arotake

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ER06-0001

Joanna Perry
Chair
Financial Reporting Standards Board
Institute of Chartered Accountants of New Zealand
P O Box 11 342
WELLINGTON

Dear Joanna

FRS-29: PROSPECTIVE FINANCIAL INFORMATION

The Local Government Act 2002 (LGA 2002) has made a number of changes to the planning and reporting documents to be prepared by local authorities. These documents now include a ten year Long-Term Council Community Plan (LTCCP), Annual Plans and Annual Reports. Section 111 requires that all information required to be presented in these documents 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”.

It is our expectation that both the Long-Term Council Community Plans and Annual Plans must accordingly be presented in accordance with FRS-29: Prospective Financial Information (to the extent that that standard applies to the information required to be presented). We have undertaken a process to review FRS-29 for its application to these two documents in future years – this process has identified a number of issues which we consider deserve consideration by the Financial Reporting Standards Board and, in due course, the Accounting Standards Review Board.

We have not undertaken an exhaustive analysis as yet and would be pleased to work with the Financial Reporting Standards Board to do that over the period ahead. However, our review to date has indicated that the fundamentals of FRS-29 are sound and able to be applied to LTCCPs and Annual Plans. However, there are a number of areas in which FRS-29 is out of date or insufficiently reflects the nature of prospective financial information in a public sector environment that we think necessitate consideration by the Board. We set out those issues below.

Prospective Financial Information Reported in New Zealand

We ask the Board to consider the issues we raise below, and the importance we attach to FRS-29 being amended to address aspects which are outdated and which insufficiently reflect

the public sector dimension, in the light of the likely future application of the standard. The original FRS-29 was issued in March 1993 primarily for application to prospective financial information in prospectuses. In fact it specifically did not apply to budgetary information published by public sector entities under the Local Government and Public Finance Acts. The standard was amended in 1996 to extend its application to public sector entities.

The requirement of the Local Government Act that LTCCPs be prepared in accordance with generally accepted accounting practice significantly increases the quantum of prospective financial information to be presented in accordance with FRS-29. Each year every local authority will present one document which is prepared in accordance with FRS-29 (either an LTCCP or an Annual Plan). When this is considered together with the number of central government entities which are required to publish either annual or three-yearly prospective financial information then it becomes clear that the primary application of this standard is in the public sector. However the standard continues to have a strong “flavour” of profit-oriented entities and prospectuses. We think that the standard should be reviewed to ensure that its application is appropriate to **all** the circumstances under which it must be applied.

Impacts of International Harmonisation

In our review of the standard we have identified a number of paragraphs which will need to be amended to ensure that they align with the NZ IFRSs and NZ IASs which the Board is developing. Examples are paragraph 5.3 (with its reference to a statement of prospective movements in equity), paragraph 5.4 (where the language and structure need to be aligned with NZ IAS 1), paragraph 5.6 (which specifies the requirements for a statement of prospective movements in equity), paragraphs 5.7 and 5.8 (which specify the options for presenting a statement of prospective financial position) and paragraph 5.10 (which explicitly refers to FRS-1: Disclosure of Accounting Policies).

Outdated References

Our review also identified a number of outdated references. These include the reference to Statements of Corporate Intent in various parts of paragraph 2.4 (now Statements of Intent), reference to local authority trading enterprises in paragraph 2.4(d) (now Council Controlled Organisations) and reference to Long-Term Financial Strategies (these documents are no longer required to be prepared and are replaced to an extent by LTCCPs).

The reference to Long-Term Financial Strategies (which were not required to comply with generally accepted accounting practice) should in our view be deleted from paragraph 2.4. In the case of the other matters the relevant paragraphs need to be updated. We also note that an update is needed to paragraph 4.6(e) when it refers to the Annual Plans of local authorities – it should now also refer to LTCCPs.

Appropriateness in a Public Sector Environment – Specific Issues

We have identified a small number of specific issues in our review of the standard which we ask the Board to consider and provide specific guidance on.

1. Paragraph 4.6 states that prospective financial information will normally comprise a statement of prospective financial performance and a statement of accounting

policies and may include one or more other statements. Our understanding of the LGA 2002 suggests very strongly that it was the intention that a full set of financial statements be presented in an LTCCP and perhaps also in an Annual Plan. We are concerned at the possibility that paragraph 4.6 might be argued to permit these documents to include only a statement of prospective financial performance and a statement of accounting policies.

2. Paragraph 4.8 states explicitly that prospective financial information does not include prospective non-financial information. The LTCCP is required to include a significant amount of information which is not financial. This information would need to be consistent with, and in fact provide the basis on which, the financial information is prepared (information about assets, service levels etc.). We think that the statement in paragraph 4.8 should be reconsidered in the light thereof, at least to the extent that it applies to public benefit entities publishing non-financial information which is integrally associated with financial information.
3. Paragraph 5.1 states that prospective financial information is to be presented in the format expected to be used in future for reporting historical financial information. One interpretation of this requirement presented to us is that where future historical financial information is to be presented for both a parent entity and group then the prospective financial information should also be for both the parent entity and group. This interpretation is however at odds with the LGA 2002 requirements for LTCCPs. Under the LGA 2002 prospective financial information is required to be presented at least for the local authority parent entity and may include the information of council controlled organisations. We think paragraph 5.1 should be reconsidered to clarify the information that is expected. If it is considered that paragraph 5.1 requires both parent and group information, this will create significant difficulties for local authorities that have controlling interests in commercial entities such as airports or ports. Obtaining 10 year forecast information for such entities is both very difficult and potentially very costly. If, on the other hand, only parent information is required, this may permit the exclusion of key information due to activities being undertaken outside of the parent Council. In considering changes to paragraph 5.1 the legislative requirements for LTCCPs will need to be considered.
4. Paragraph 5.14 discusses the time period for which prospective financial information should be presented. We think it inadequately reflects the public sector environment – an environment in which entities are able to source revenues using coercive powers, where the assets of many entities (including all local authorities) are extremely long lived and where most of the services are not subject to competition and are expected to be provided for the long term. In these circumstances, presenting 10 years' future oriented information is not unreasonable. We acknowledge of course that circumstances will change and organisations will make new policy shifts over time. These will however be “at the margin” and do not invalidate presenting the information in the first place. We therefore think paragraph 5.14 should acknowledge this, bearing in mind that the broadest application of the standard will be to information presented by public benefit entities.

5. Paragraphs 5.21 and 5.22 refer in different places to plans reflecting expected “economic effects” or “economic conditions” or economic environment”. We think these paragraphs should be broadened to reflect the environment of public benefit entities.
6. There is a related issue arising from the requirement of paragraph 5.4 of FRS-9. Councils will publish prospective information about a particular year at many different times. For example the 2016 year will have been reflected in an LTCCP in 2006, 2009, 2012 and 2015 (and perhaps more often if there has been an amendment to the LTCCP over that time) and in an Annual Plan for the 2016 year. We think FRS-9 must have been intended to require a comparison against the most recent published information but this could helpfully be made explicit.

Conclusion

Our preliminary review of FRS-29 to assess how it might apply to LTCCPs and Annual Plans of local authorities has identified issues which are of concern to us but has also identified a number of changes that are needed to the standard to ensure it is a credible and appropriate standard in the new standard-setting environment. We request the Board to review the standard and to consider the issues raised above as part of that review. The Audit Office fully supports having a standard which applies to future oriented information presented by entities in the public sector. Our review has confirmed the merits of the fundamentals of this standard and we do not think that the matters we are raising would in any way challenge those fundamentals. We would be pleased to discuss these issues with the Board and to participate in any review process the Board initiated.

I can be contacted on 04 917 1512 if you would like any further information or to discuss the issues we have raised.

Yours sincerely

Kevin Simpkins
Deputy Controller & Auditor-General