

# Departmental Disclosure Statement

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Accounting Infrastructure Reform Bill
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2013 No 180
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The departmental disclosure statement for a government Bill seeks to bring together in one place a range of information to support and enhance the Parliamentary and public scrutiny of that Bill.

It identifies:

- the general policy intent of the Bill and other background policy material;
- some of the key quality assurance products and processes used to develop and test the content of the Bill;
- the presence of certain significant powers or features in the Bill that might be of particular Parliamentary or public interest and warrant an explanation.

This disclosure statement was prepared by the Ministry of Business, Innovation and Employment.

The Ministry of Business, Innovation and Employment certifies that, to the best of its knowledge and understanding, the information provided is complete and accurate at the date of finalisation below.

31 October 2013

## Contents

Contents .....	2
Part One: General Policy Statement .....	3
Part Two: Background Material and Policy Information .....	6
Part Three: Testing of Legislative Content .....	8
Part Four: Significant Legislative Features.....	10
Appendix One: Further Information Relating to Part Four.....	13

## Part One: General Policy Statement

The main purpose of the Accounting Infrastructure Reform Bill is to enable the accounting and audit industry to be more efficient and effective.

The Bill achieves this by—

- amending rules on who may perform statutory audits to enable more people who are competent to perform audits to do so:
- replacing legislative references to a chartered accountant with references to a qualified statutory accountant to enable more people who are competent to perform statutory accountancy functions to do so:
- reducing restrictions on legal form for audit firms while maintaining the quality of audits through standards and checks:
- introducing a requirement for independent assurance of financial statements for medium sized and large charities:
- allowing the New Zealand Institute of Chartered Accountants (NZICA) more freedom in how to structure itself.

These measures will support the aims of the Business Growth Agenda. A more competitive and efficient accounting market will provide better business advice for New Zealand firms. An effective audit industry, giving better assurance for users of financial statements, will build confidence in financial markets. The Bill will continue the changes begun by the Financial Markets Conduct Act 2013 and the Financial Reporting Act 2013. Together the 3 Acts contribute to the overarching policy of promoting and facilitating the development of fair, efficient, and transparent financial markets and to promoting the confident and informed participation of businesses, investors, and consumers in the financial markets.

Legislative reforms are necessary to achieve the objective because the existing barriers to efficiencies, for example, the restrictions on which people and entities may perform audits, are contained in legislation. To achieve better assurance about charities' financial statements, legislative measures are necessary to ensure consistent compliance.

### Amending rules on who may perform statutory audits

Auditors are regulated in one of the following ways in New Zealand, depending on the type of entity they audit:

- auditors of FMC reporting entities (this group includes issuers of financial products) under the Financial Markets Conduct Act 2013 must be licensed by an accredited professional body.
- Accreditation is granted by the Financial Markets Authority under the Auditor Regulation Act 2011. An audit of an FMC reporting entity is called an **FMC audit**:
- there is currently no single consistent qualification standard for audits that are required by legislation, but are not audits of FMC reporting entities (**non-FMC audits**). Some Acts specifically require the auditor to be a chartered accountant. Many Acts will cross-refer to the definition of qualified auditor in the Financial Reporting Act 2013:
- auditors who perform audits that are not required by statute (for example, audits of incorporated societies) are not regulated by legislation, although some professional bodies choose to impose their own standards on members performing these audits.

The Bill amends the qualification requirement in the Financial Reporting Act 2013 relating to non-FMC audits, in the second category above. It adds to, rather than replaces, the existing ways to be a qualified auditor under that Act.

The Bill enables accounting professional bodies accredited under the Auditor Regulation Act 2011 to assess and recognise their members as qualified to perform non-FMC audits. This is an extension of accredited bodies' powers, in addition to their role relating to FMC audits in the first category above.

The Bill also amends the few remaining public Acts that had required a chartered accountant to perform a statutory audit, to instead cross-refer to the definition of qualified auditor in the Financial Reporting Act 2013. This makes the statutory auditor qualification requirement (for all auditors except those of FMC reporting entities) consistent across all public statutes.

The Bill also adds a requirement that chartered accountants must be recognised by NZICA in order to perform statutory audits. This reflects NZICA's existing practice of imposing requirements beyond merely being a chartered accountant. It also ensures consistency with the requirement for members of accredited bodies to be recognised.

The Bill requires professional bodies to maintain a public record of recognised members and incorporated firms and to keep that recognition under review. The Bill creates offences for misleading behaviour for the purpose of obtaining recognition and acting as an auditor without being qualified. It also restates the offence of holding oneself out as a qualified auditor.

### **Enabling people who are competent to perform legislative accountancy roles to do so**

The Bill replaces references to a chartered accountant in various Acts with references to a qualified statutory accountant, where the context relates to specifying who may perform an accounting-related statutory role. The existing provisions had limited who could perform these roles based on membership of NZICA.

The policy behind the change is that the limitation should instead be based on competency to perform the role. The new definition of qualified statutory accountant allows members of accredited bodies to perform these roles. It is intended to improve the efficiency of the accounting industry by enabling more competition.

### **Reducing restrictions on legal form for audit firms**

The Bill removes the ban on companies performing statutory audits. It allows New Zealand audit firms to incorporate using the company form. It also allows incorporated overseas audit firms to operate in New Zealand, providing they satisfy certain requirements.

This measure reflects moves in other jurisdictions and other professional services industries (for example, the legal profession) to allow incorporation. It will improve the efficiency of the audit industry by allowing greater freedom to structure a firm in the most efficient way.

The Bill requires incorporated audit firms performing non-FMC audits to maintain a link to a professional accounting body through a director (or equivalent) and to be recognised similarly to an individual. Incorporated audit firms performing FMC audits will need to be registered under the Auditor Regulation Act 2011.

The Bill also provides for standards relating to an incorporated audit firm's ownership, governance, compliance systems, and professional indemnity insurance to be set in regulations. These requirements will ensure auditor independence, regulatory oversight, and effective remedies are maintained, regardless of the legal structure chosen by the firm.

### **Requiring independent review of charities' financial statements**

The Bill creates a new requirement for large charitable entities to have their financial statements audited by a qualified auditor. Large charitable entities are those with a total operating expenditure of \$1 million or more over each of the 2 preceding accounting periods.

The Bill also requires medium-sized charitable entities to have their financial statements audited or reviewed by a qualified auditor. Medium-sized charitable entities are those that are not large but have had a total operating expenditure of \$500,000 or more over each of the 2 preceding accounting periods.

These provisions will improve the effectiveness of financial reporting by ensuring sizeable charities' financial statements are of high quality. These changes will also support amendments made to the Charities Act 2005 by the Financial Reporting (Amendments to Other Enactments) Act 2013 (which requires charitable entities to prepare financial statements in accordance with financial reporting standards issued by the External Reporting Board).

### **Allowing NZICA to structure itself in the way its members choose**

The Bill makes amendments that are necessary to facilitate NZICA's proposed agreement to join the Institute of Chartered Accountants in Australia in a combined new trans-Tasman institute.

The new provisions define and preserve to NZICA the functions relating to the regulation of its members. These functions will continue to be performed by NZICA for New Zealand members. All other functions will be able to be delegated, for example to a specified association such as the new trans-Tasman institute. This ability to delegate will enable the 2 institutes to consolidate various member services, such as marketing, membership, advocacy, education, and training in the trans-Tasman institute and achieve greater efficiency and benefits of scale by only maintaining a single system for each of these services.

The Bill enables NZICA's rules to require that members must also be members of another association of accountants. This aims to enable the parties' agreement to be as close to an amalgamation as possible. It will ensure NZICA does not have to maintain a duplicative membership system, thus allowing it to achieve the efficiencies and benefits of scale noted above.

The Bill allows the specified association to perform the delegable functions in the interests of the specified association or its members, even if it is not in NZICA's interests, as long as it does not materially prejudice NZICA's ability to carry out its regulatory function. Similarly, NZICA's rules may allow any members of NZICA's Council and Executive Board who are appointed by the specified association to act in the interests of the specified association or its members in performing their functions as long as this does not materially prejudice NZICA's ability to carry out its regulatory function. This further supports the goal of achieving an agreement as close to an amalgamation as possible.

The Bill removes the requirement for NZICA to have a President and Vice-President. The presidential roles have no functions conferred by the Act as the substantive role of governing NZICA falls to the Council and Executive Board. The proposed trans-Tasman institute will have its own presidential roles, rendering the New Zealand equivalents unnecessary.

Lastly, the Bill transfers some tasks from NZICA's Council to its Executive Board as they do not fit with the Council's role of setting high-level strategy and governance principles. It is intended that the Bill be divided at the committee of the whole House stage into separate Bills as follows:

- *subpart 1 of Part 1* will become the Auditor Regulation Amendment Bill;
- *subpart 2 of Part 1* will become the Charities Amendment Bill;
- *subpart 3 of Part 1, Part 2, and Schedules 1 and 2* will become the Financial Reporting Amendment Bill;
- *subpart 4 of Part 1* will become the New Zealand Institute of Chartered Accountants Amendment Bill.

## Part Two: Background Material and Policy Information

### Published reviews or evaluations

<b>2.1. Are there any publicly available inquiry, review or evaluation reports that have informed, or are relevant to, the policy to be given effect by this Bill?</b>	<b>YES</b>
For the policy introducing mandatory assurance for medium and large registered charities, relevant reports which were a significant source of evidence underpinning the analysis were <ul style="list-style-type: none"><li>• Rowena M S Sinclair, <i>Understandability and Transparency of the Financial Statements of Charities</i>, PhD thesis submitted to Auckland University of Technology (2010).</li><li>• Carolyn Cordery and Kapil Patel, <i>Financial Reporting Stocktake: An Assessment of Accountability through Charities' Filing on New Zealand's Charities Register</i>, Victoria University of Wellington (2011).</li><li>• Carolyn J Cordery, <i>Incidence of Auditing and Assurance in Charities</i>, Victoria University of Wellington (2012).</li></ul>	

### Relevant international treaties

<b>2.2. Does this Bill seek to give effect to New Zealand action in relation to an international treaty?</b>	<b>NO</b>

### Regulatory impact analysis

<b>2.3. Were any regulatory impact statements provided to inform the policy decisions that led to this Bill?</b>	<b>YES</b>
<ol style="list-style-type: none"><li>1. <i>Audit firm incorporation</i>, Ministry of Business, Innovation and Employment, 13 May 2013</li><li>2. <i>Financial statements assurance for large and medium charities</i>, Ministry of Business, Innovation and Employment, 28 June 2013</li><li>3. <i>Restricted areas of statutory audit work</i>, Ministry of Business, Innovation and Employment, 13 May 2013</li><li>4. <i>NZICA and ICAA merger reforms</i>, Ministry of Business, Innovation and Employment, 13 May 2013</li></ol> All Regulatory Impact Statements can be accessed at: <a href="http://www.med.govt.nz/business/business-law/current-business-law-work/accounting-infrastructure-reform-bill">http://www.med.govt.nz/business/business-law/current-business-law-work/accounting-infrastructure-reform-bill</a>	

<b>2.3.1. If so, did the RIA Team in the Treasury provide an independent opinion on the quality of any of these regulatory impact statements?</b>	<b>NO</b>
None of the Regulatory Impact Statements met the threshold for receiving an independent opinion on the quality of the RIS from the RIA team based in the Treasury.	

<b>2.3.2. Are there aspects of the policy to be given effect by this Bill that were not addressed by, or that now vary materially from, the policy options analysed in these regulatory impact statements?</b>	<b>NO</b>

## Extent of impact analysis available

<b>2.4. Has further impact analysis become available for any aspects of the policy to be given effect by this Bill?</b>	<b>NO</b>

<b>2.5. For the policy to be given effect by this Bill, is there analysis available on:</b>	
<b>(a) the size of the potential costs and benefits?</b>	<b>YES</b>
<b>(b) the potential for any group of persons to suffer a substantial unavoidable loss of income or wealth?</b>	<b>NO</b>
<p>For the policy introducing mandatory assurance for medium and large registered charities, estimated expected costs can be found in the RIS <i>Financial statements assurance for large and medium charities</i>, at paragraphs 31 and 51-53.</p> <p><a href="http://www.med.govt.nz/business/business-law/current-business-law-work/accounting-infrastructure-reform-bill">http://www.med.govt.nz/business/business-law/current-business-law-work/accounting-infrastructure-reform-bill</a></p>	

<b>2.6. For the policy to be given effect by this Bill, are the potential costs or benefits likely to be impacted by:</b>	
<b>(a) the level of effective compliance or non-compliance with applicable obligations or standards?</b>	<b>YES</b>
<b>(b) the nature and level of regulator effort put into encouraging or securing compliance?</b>	<b>YES</b>
<p>For the policy introducing mandatory assurance for medium and large registered charities, detail relating to the impact of compliance and the nature of regulator input into compliance can be found in the RIS <i>Financial statements assurance for large and medium charities</i>, at paragraphs 86-95.</p> <p><a href="http://www.med.govt.nz/business/business-law/current-business-law-work/accounting-infrastructure-reform-bill">http://www.med.govt.nz/business/business-law/current-business-law-work/accounting-infrastructure-reform-bill</a></p>	

## Part Three: Testing of Legislative Content

### Consistency with New Zealand's international obligations

<b>3.1. What steps have been taken to determine whether the policy to be given effect by this Bill is consistent with New Zealand's international obligations?</b>
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Officials consulted internal government experts on audit, accounting and financial statements and are confident there are no international obligations directly relating to the matters in this Bill. As the Bill does not contain any measures which conflict with the principles of most favoured nation and non-discrimination on which treaties are based, we are also confident that the Bill does not indirectly impact on any international obligations.

### Consistency with the government's Treaty of Waitangi obligations

<b>3.2. What steps have been taken to determine whether the policy to be given effect by this Bill is consistent with the principles of the Treaty of Waitangi?</b>
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No specific steps have been taken to determine that the policy is consistent with the principles of the Treaty of Waitangi.

### Consistency with the New Zealand Bill of Rights Act 1990

<b>3.3. Has advice been provided to the Attorney-General on whether any provisions of this Bill appear to limit any of the rights and freedoms affirmed in the New Zealand Bill of Rights Act 1990?</b>	<b>YES</b>
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The advice from the Attorney-General on whether the Bill is consistent with the New Zealand Bill of Rights Act 1990 is normally made available on the Ministry of Justice website before the Bill is introduced. That website is: <http://www.justice.govt.nz/policy/constitutional-law-and-human-rights>

### Offences, penalties and court jurisdictions

<b>3.4. Does this Bill create, amend, or remove:</b>	
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<b>(a) offences or penalties (including infringement offences or penalties and civil pecuniary penalty regimes)?</b>	<b>YES</b>
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<b>(b) the jurisdiction of a court or tribunal (including rights to judicial review or rights of appeal)?</b>	<b>NO</b>
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The Bill creates offences in clauses 24, 31, 32, 37, and removes an offence in clause 49.

<b>3.4.1. Was the Ministry of Justice consulted about these provisions?</b>	<b>YES</b>
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A representative of the Ministry of Justice's Criminal Law Team was consulted about these provisions early in the drafting stage of the Bill's development. The Ministry of Justice has also vetted the offences as part of the departmental consultation.

### Privacy issues

<b>3.5. Does this Bill create, amend or remove any provisions relating to the collection, storage, access to, correction of, use or disclosure of personal information?</b>	<b>YES</b>
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The Bill creates a requirement for professional bodies to maintain a record of all individuals and bodies corporate it has recognised as able to perform non-FMC statutory audits, as well as all cancellations or suspensions of such recognition. The professional body must publish this record on its internet site.

This is to enable clients and users of financial statements to satisfy themselves that the person seeking engagement, or who audited a set of financial statements, is suitably qualified.

**3.5.1. Was the Privacy Commissioner consulted about these provisions?**

**YES**

The Privacy Commissioner was consulted and changes made to the requirements in clause 31 (new section 35J) as a result. That clause requires professional bodies to publish a record of people they have recognised as qualified to perform statutory audits.

**External consultation**

**3.6. Has there been any external consultation on the policy to be given effect by this Bill, or on a draft of this Bill?**

**YES**

The Ministry of Economic Development undertook targeted consultation on audit firm incorporation in December 2011. Submitters all supported the proposal to allow New Zealand audit firms to incorporate, but varied as to what level of restrictions should be placed on audit firms that choose to incorporate.

NZICA has consulted widely with its members on its proposed amalgamation with ICAA. As part of this it thoroughly explained the implications. This included detailed of the proposed Rule changes and a summary of the legislative changes. All chartered accountants had an opportunity to vote on the proposal in October 2013.

The Ministry of Business, Innovation and Employment undertook targeted consultation on who may perform non-FMC statutory audits in February 2013. Most submitters agreed that accredited bodies should be able to authorise their members to perform non-FMC statutory audits. Some also suggested a co-regulatory regime be implemented, with the Financial Markets Authority (FMA) overseeing the accredited bodies in their role relating to non-FMC statutory audits. However, they were anxious that it should not impose excessive cost on the industry nor distract the FMA from its core role.

Two consultation rounds were held on the issue of audit and assurance for charities. First, in April 2012, a tentative proposals paper sought views on mandatory audit for registered charities with annual operating expenditure of \$300,000 or more and mandatory audit or review for those between \$200,000 to \$300,000. Workshops were held in 5 centres with over 200 participants. Submissions on that paper informed a concrete proposals paper, issued in February 2013, which raised the dollar thresholds for the tiers to \$400,000 and \$1 million. These proposals were explained in a roadshow of 23 seminars in 15 locations, attracting 2000 attendees. There was broad support for the main proposals in the second discussion paper.

The Bill has been developed in consultation with FMA and the Registrar of Companies. NZICA and CPA Australia, the two main accounting professional bodies in operation in New Zealand, were also consulted throughout and had sight of two early drafts of the Bill.

**Other testing of proposals**

**3.7. Have the policy details to be given effect by this Bill been otherwise tested or assessed in any way to ensure the Bill's provisions are workable and complete?**

**NO**

## Part Four: Significant Legislative Features

### Compulsory acquisition of private property

4.1. Does this Bill contain any provisions that could result in the compulsory acquisition of private property?	NO

### Charges in the nature of a tax

4.2. Does this Bill create or amend a power to impose a fee, levy or charge in the nature of a tax?	NO

### Retrospective effect

4.3. Does this Bill affect rights, freedoms, or impose obligations, retrospectively?	NO

### Strict liability or reversal of the usual burden of proof for offences

4.4. Does this Bill:	
(a) create or amend a strict or absolute liability offence?	YES
(b) reverse or modify the usual burden of proof for an offence or a civil pecuniary penalty proceeding?	NO
The offences in clauses 24, 31, 32 and 37 create strict liability offences. More information and the justifications are set out in Appendix 1.	

### Civil or criminal immunity

4.5. Does this Bill create or amend a civil or criminal immunity for any person?	NO

### Significant decision-making powers

4.6. Does this Bill create or amend a decision-making power to make a determination about a person's rights, obligations, or interests protected or recognised by law, and that could have a significant impact on those rights, obligations, or interests?	YES
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The Bill will allow professional bodies accredited under the Auditor Regulation Act 2011 to recognise their members as qualified to perform non-FMC statutory audits and statutory accounting functions. It will also allow NZICA, other accredited bodies and approved professional bodies (which are approved by the Registrar of Companies under the Financial Reporting Act) to recognise incorporated audit firms as qualified to perform statutory audits.

The professional bodies will be able to set their own criteria for recognising these parties, but there will be certain requirements in regulation relating to bodies corporate that the professional bodies will have to apply. The safeguards on this power are that NZICA and other accredited bodies have been assessed by the FMA, which was satisfied that their systems, processes and procedures are suitable to license their members for the (higher risk) FMC audits. They will also be subject to continuing oversight by the FMA in respect of their role relating to licensing members. Similarly, approved professional bodies have been assessed and approved by the Registrar of Companies. This gives comfort that the professional bodies' decisions relating to recognition will be robust and they will use their power appropriately.

The Bill gives the FMA a decision making power to approve incorporated audit firms as suitable to perform FMC audits. This power will be subject to regulations setting requirements for firms. The FMA may prescribe additional criteria by notice in the Gazette. Such notices will be subject to disallowance and must be presented to Parliament. The FMA is also subject to monitoring by the Minister of Commerce.

The Bill also gives the Registrar the power to approve overseas countries and types of corporate structures as appropriate to perform audits in New Zealand. The Bill sets out matters the Registrar must be satisfied of in exercising this power, to ensure the exercise of this power maintains auditor independence and competence.

All the above entities will be subject to administrative law and the rules of natural justice in the exercise of their powers.

## Powers to make delegated legislation

<b>4.7. Does this Bill create or amend a power to make delegated legislation that could amend an Act, define the meaning of a term in an Act, or grant an exemption from an Act or delegated legislation?</b>	<b>YES</b>
<p>The Bill will create a power for the Governor General to name a 'specified association' for the purposes of the Act by Order in Council. This will enable the new trans-Tasman professional accounting body to be named for the purposes of the Act, once the body comes into existence.</p> <p>This power must only be used on recommendation of the Minister of Commerce, who in turn must only make a recommendation after consulting the New Zealand Institute of Chartered Accountants.</p>	
<b>4.8. Does this Bill create or amend any other powers to make delegated legislation?</b>	<b>YES</b>
<p>The Bill amends NZICA's powers to make Rules that will apply to its members, allowing it to require its members to also belong to the specified association.</p> <p>These powers are narrowly defined and the resulting Rules will be disallowable instruments. Also, the NZICA membership has had the opportunity to vote on the entire proposal to join the Australian institute in a new trans-Tasman body, of which these Rules form a part, and they voted in favour.</p> <p>The Bill also creates a power to make regulations setting minimum standards and requirements to apply to companies and overseas bodies corporate performing FMC and non-FMC statutory audits.</p>	

**Any other unusual provisions or features**

<b>4.9. Does this Bill contain any provisions (other than those noted above) that are unusual or call for special comment?</b>	<b>NO</b>

## Appendix One: Further Information Relating to Part Four

### Strict liability or reversal of the burden of proof for offences - question 4.4

The following proposed offences are strict liability offences:

- Clause 24, new section 42E of the Charities Act. The offence is for a charitable entity failing to have its financial statements audited or reviewed as required by new s42C. It is punishable by a fine not exceeding \$50,000.

This is a strict liability offence because any mental element would be inherently impractical to test as it would only be within the knowledge of the defendant. It is significantly easier for the defendant to show why the defendant was not at fault, than it is for the prosecution to prove a mental element. If it required a mental element, an assertion by the charitable entity that it 'forgot' to have its financial statements audited would preclude a conviction, with the prosecution having a very difficult task to disprove this.

- Clause 31, new section 35F of the Financial Reporting Act, insofar as it relates to section 35D. The offence is for a body corporate auditor failing to ensure its engagement director is a qualified auditor.  
Every director of the body corporate also commits an offence. There is a defence available for a director if he or she took all reasonable steps to ensure the duty would be complied with, or to ensure the body corporate complied with the duty, or in the circumstances he or she could not reasonably be expected to take steps to ensure the body corporate complied with the duty. It is punishable by a fine not exceeding \$50,000 for individuals and \$150,000 for bodies corporate.
- Clause 31, new section 35J of the Financial Reporting Act. The offence is for if the New Zealand Institute of Chartered Accountants, any other accredited body or an approved association fails to keep a record of those it has recognised as a qualified auditor or fails to keep that record available and prominent on its internet site.
- Clause 32, new section 38A of the Financial Reporting Act. The offence is for acting as the auditor of a specified entity or of its financial statements if the person is not a qualified auditor in respect of the entity. It is punishable by a fine not exceeding \$50,000 for individuals and \$150,000 for bodies corporate.
- Clause 32, new section 38B of the Financial Reporting Act. The offence is for holding out that a person is recognised as a qualified auditor if they are not; or qualified to act as the auditor of a specified entity, if they are not. It is punishable by a fine not exceeding \$50,000 for individuals and \$150,000 for bodies corporate.
- Clause 37, new section 52A of the Financial Reporting Act. The offence is for holding out that one is qualified to act in respect of a matter which requires a qualified statutory accountant, if one is not a qualified statutory accountant. It is punishable by a fine not exceeding \$50,000 for individuals and \$150,000 for bodies corporate.

All of the above offences are public welfare regulatory offences that seek to protect the public. The qualification requirements in the Financial Reporting Act are intended to ensure that

- statutory audit and statutory accounting functions are performed to a high standard and
- the public can be confident of that fact.

Having unqualified people performing this work raises the risk that this standard is not met, which in turn creates risks for those relying on the relevant financial statements or statutory accounting function. Those choosing to perform statutory audits and accounting work are voluntarily involving themselves in a heavily regulated, highly specialist activity and therefore must meet all standards required by that regulation.

The maximum penalties for all of these offences are at the low end of the scale. For these reasons we have concluded the strict liability offences are justified.