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- 5.28 As well as a decision on how a set of New Zealand financial reporting standards will be created in future, there will need to be a decision about appropriate differential requirements for small entities. In my view, irrespective of the approach adopted, it is important to ensure that the reporting requirements for small entities broadly reflect their size and complexity, and the needs of people using the information reported.
- 5.29 The current differential reporting framework is designed to ease the compliance burden on smaller entities. Following the deferral of mandatory adoption of NZ IFRS (as outlined in Part 2, starting at paragraph 2.59), fewer small entities in the private sector reported in accordance with NZ IFRS. However, most smaller entities in the public sector were unable to defer NZ IFRS. Therefore, the standard setter now needs to review the differential reporting concessions available to small entities, particularly for the public sector.
- 5.30 In my view, more concessions should be available to smaller entities in the public sector. This would ensure that the accountability obligations of such entities are not disproportionate to their size while still meeting the needs of people using their financial statements. It may be that a simplified set of requirements can be established for certain homogenous sub-sectors within the public sector (for example, the schools sector).
- 5.31 Associated with any change in the approach to setting standards would be a need to review the way standard setting is carried out.
- 5.32 For the past 16 years, there have been two parties involved in setting financial reporting standards: the Financial Reporting Standards Board that writes standards, and the Accounting Standards Review Board that reviews and approves those standards. Therefore, setting financial reporting standards has required the co-operation of both boards.
- 5.33 Having two separate parties involved in setting financial reporting standards is different from what happens in other jurisdictions such as Australia, the United Kingdom, Canada, and the United States. In those jurisdictions the body that writes the standards sets the standards.
- 5.34 In my view, the writing and approving of financial reporting standards needs to be the responsibility of one board, a statutory board. I acknowledge that there would need to be changes to the Accounting Standards Review Board's powers for it to be that statutory board. This would require legislative change.

- 5.35 The members of the statutory board would need to be selected from appropriately skilled people, so that collectively the board had experience in dealing with issues across the range of reporting entities for which standards are set.

### Concluding comments

- 5.36 In my view, the Accounting Standards Review Board needs to be given the power to create financial reporting standards (as opposed to only approving or not approving standards submitted to it). If the Board had that power, it could then decide the best way forward and implement it so that standard setting for the public sector could be put “back on track”.
- 5.37 In my view, significant change rather than fine tuning is required. Such changes would include requiring, at least, listed issuers to adopt pure IFRS, and allowing any other profit-oriented entities wishing to state their compliance with IFRS to also adopt pure IFRS. In this way, these entities would be using standards designed for them.
- 5.38 The challenge for the Accounting Standards Review Board would then be to decide the most appropriate approach to setting standards for all other reporting entities. I have outlined four broad approaches the Accounting Standards Review Board could think about. The underlying premise of these four approaches is that continuing the status quo is not an option.
- 5.39 All four approaches have advantages and disadvantages. In my view, any assessment of these various approaches essentially comes down to a trade-off between quality of financial reporting standards (including the ability of entities to readily apply the standards) and the cost of setting standards to achieve that quality. I would strongly prefer an approach that emphasises the quality of financial reporting standards for the public sector.



# Appendix 1

## Comparing NZ IFRS with previous financial reporting standards for the public sector

- A1.1 This Appendix compares NZ IFRS for public benefit entities with financial reporting standards that applied before NZ IFRS (referred to in this Appendix as “previous standards”). The comparison is based on the standards and interpretations in place under NZ IFRS as at 31 March 2009.
- A1.2 Interpretations of standards, referred to as NZ SIC and NZ IFRIC, have been linked where possible to the standard to which they primarily relate. NZ SIC are the New Zealand equivalents to interpretations established by the former Standard Interpretations Committee and the NZ IFRIC are the New Zealand equivalents to interpretations established by the International Financial Reporting Interpretations Committee.
- A1.3 The comments reflect the judgements my staff and I have made, at a high level, about what has been gained or lost from the adoption of NZ IFRS.

NZ IFRS standard	Previous standard	Comments
NZ Framework <i>New Zealand Equivalent to the IASB Framework for the Preparation and Presentation of Financial Statements</i>	<i>Statement of Concepts for General Purpose Financial Reporting</i>	The NZ Framework includes some paragraphs to reflect the public benefit entity environment. However, the NZ Framework contains less guidance than the previous Statement of Concepts in important areas (for example, contributions by owners). This is a problem for the public sector.
NZ IFRS 1 <i>First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards</i>	No previous standard on this subject	NZ IFRS 1 relates to the transition to NZ IFRS.  In general, I am not aware of any concerns with this standard for the public sector.
NZ IFRS 2 <i>Share-based Payment</i> (includes interpretations NZ IFRIC 8 and NZ IFRIC 11)	No previous standard on this subject	NZ IFRS 2 generally does not apply to the public sector, except for listed entities such as Air New Zealand.

NZ IFRS standard	Previous standard	Comments
NZ IFRS 3 (revised) <i>Business Combinations</i>	FRS-36 <i>Accounting for Acquisitions Resulting in Combinations of Entities or Operations</i>	<p>NZ IFRS 3 (revised) includes some changes from the previous standard, such as the requirement to value and recognise contingent liabilities acquired, and the prohibition on amortising goodwill.</p> <p>NZ IFRS 3 (revised) includes no changes from IFRS 3 (revised) and includes no guidance for public benefit entities. I am concerned that applying NZ IFRS 3 (revised) in some instances might result in misleading information for people using public benefit entities' financial statements. This was also the case under FRS-36.</p>
NZ IFRS 4 <i>Insurance Contracts</i>	FRS-34 <i>Life Insurance Business</i> and FRS-35 <i>Financial Reporting of Insurance Activities</i>	<p>NZ IFRS 4 includes some changes from previous standards. For example, NZ IFRS 4 requires a claims liability to be greater than the mid-point estimate of the liability. The liability is increased by applying a risk margin and is likely to be higher than the amount expected to be paid out in claims.</p> <p>I am concerned that including a risk margin for a public sector insurer may not give appropriate information to people using the financial statements of such insurers.</p>
NZ IFRS 5 <i>Non-current Assets Held for Sale and Discontinued Operations</i>	No previous standard on this subject, but there was some guidance in: FRS-2 <i>Presentation of Financial Reports</i> ; FRS-3 <i>Accounting for Property, Plant and Equipment</i> ; FRS-9 <i>Information to be Disclosed in Financial Statements</i> ; and SSAP 17 <i>Accounting for Investment Properties and Properties Intended for Sale</i>	<p>NZ IFRS 5 consolidates previous guidance, and changes some requirements (for example, assets classified as held for sale are not to be depreciated).</p> <p>However, there are issues specific to the public sector relating to property disposals that have not been included.</p>
NZ IFRS 6 <i>Exploration for and Evaluation of Mineral Resources</i>	No previous standard on this subject	NZ IFRS 6 has limited applicability in the public sector.

NZ IFRS standard	Previous standard	Comments
NZ IFRS 7 <i>Financial Instruments: Disclosures</i>	FRS-31 <i>Disclosure of Information about Financial Instruments</i> and FRS-33 <i>Disclosure of Information by Financial Institutions</i>	<p>NZ IFRS 7 is more comprehensive than previous standards.</p> <p>NZ IFRS 7 includes no changes from IFRS 7 for public benefit entities, and therefore all requirements apply to the public sector.</p> <p>I am not aware of any assessment of the value of the new disclosures for people using public benefit entities' financial statements, but I question the relevance of some of these new disclosures (for example, some of the required disclosures about credit risk).</p>
NZ IFRS 8 <i>Operating Segments</i>	SSAP-23 <i>Financial Reporting for Segments</i>	<p>NZ IFRS 8 sensibly does not apply to public benefit entities, given that the "management focus" required by NZ IFRS 8 is unlikely to be consistent with the accountability requirements of many public sector entities.</p>
NZ IAS 1 <i>Presentation of Financial Statements</i> (includes interpretation NZ SIC 29)	FRS-2 <i>Presentation of Financial Reports</i> and FRS-9 <i>Information to be Disclosed in Financial Statements</i>	<p>NZ IAS 1 covers similar areas as previous standards. However, NZ IAS 1 requires more disclosures. One such disclosure is about how an entity manages its "capital", which is of questionable value to people using most public benefit entities' financial statements.</p>
NZ IAS 2 <i>Inventories</i>	FRS-4 <i>Accounting for Inventories</i>	<p>NZ IAS 2 includes no major changes from the previous standard.</p> <p>However, NZ IAS 2 requires more disclosures (for example, the amount of write-down in inventories recognised as an expense). Such disclosures seem reasonable.</p>
NZ IAS 7 <i>Cash Flow Statements</i>	FRS-10 <i>Statement of Cash Flows</i>	<p>NZ IAS 7 includes no major changes from previous standards. However, NZ IAS 7 contains less guidance about such matters as GST.</p>

NZ IFRS standard	Previous standard	Comments
NZ IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i>	FRS-1 <i>Disclosure of Accounting Policies</i> and FRS-7 <i>Extraordinary Items and Fundamental Errors</i>	NZ IAS 8 includes some changes from previous standards. NZ IAS 8 requires retrospective adjustments for changes in accounting policy and correction of all material errors.  Also, NZ IAS 8 requires more disclosures, including the effects of new standards that have been issued but have yet to be put in place. Some of these disclosures are of questionable value to people using public benefit entities' financial statements.
NZ IAS 10 <i>Events after the Balance Sheet Date</i> (includes interpretation NZ IFRIC 17)	FRS-5 <i>Events after Balance Date</i>	NZ IAS 10 includes no major changes from the previous standard.
NZ IAS 11 <i>Construction Contracts</i>	FRS-14 <i>Accounting for Construction Contracts</i>	NZ IAS 11 includes no major changes from the previous standard. However, NZ IAS 11 contains more guidance and requires more disclosures.
NZ IAS 12 <i>Income Taxes</i> (includes interpretations NZ SIC 21 and NZ SIC 25)	SSAP-12 <i>Accounting for Income Tax</i>	NZ IAS 12 is unlikely to affect many public benefit entities because most such entities are not subject to income tax.  NZ IAS 12 includes a major change in the basis of calculating deferred tax for all tax-paying entities. The biggest effects in the public sector are on tax-paying entities with large infrastructure assets that are revalued.  A deferred tax liability is recognised that is well in excess of the present value of any future tax liability that is likely to be assessed.
NZ IAS 16 <i>Property, Plant and Equipment</i>	FRS-3 <i>Accounting for Property, Plant and Equipment</i>	NZ IAS 16 includes no major changes from previous standards. However, NZ IAS 16 contains less guidance on certain issues (for example, subsequent expenditure, components, and use of indices in a depreciated replacement cost valuation).  Much of the material from the previous standard that has not been included in NZ IAS 16 directly affects the public sector.

NZ IFRS standard	Previous standard	Comments
NZ IAS 17 <i>Leases</i> (includes interpretations NZ SIC 15, NZ SIC 27, and NZ IFRIC 4)	SSAP-18 <i>Accounting for Leases and Hire Purchase Contracts</i>	NZ IAS 17 includes no major changes from previous standards. However, NZ IAS 17 requires additional disclosures for both lessees and lessors, which seem reasonable.
NZ IAS 18 <i>Revenue</i> (includes interpretations NZ SIC 31, NZ IFRIC 13, NZ IFRIC 15, and NZ IFRIC 17)	No previous standard on this subject	NZ IAS 18 deals only with revenue from exchange transactions; therefore it does not cover many of the revenue transactions in the public sector.  NZ IAS 18 is not particularly clear, and is confusing and contradictory between the standard and examples set out in the appendix.  The real issue for the public sector is non-exchange revenue, for which there is currently no standard under NZ IFRS. A proposed standard is expected to be issued for comment soon.
NZ IAS 19 <i>Employee Benefits</i> (includes interpretation NZ IFRIC 14)	No previous standard on this subject	NZ IAS 19 introduced the requirement to recognise a liability for sick leave, which required a significant amount of work in the transition to NZ IFRS. The standard is not clear about the calculation of liabilities for some sick leave benefit schemes common in the public sector.  It is questionable whether the requirement to recognise a sick leave liability meets the cost-benefit test.  Also, NZ IAS 19 requires use of the high-quality corporate bond rate for all entities in discounting long-term employee benefits. (If there is no deep market for corporate bonds, use of the government bond rate is permitted.) The corporate bond rate is not relevant to the public sector.
NZ IAS 20 <i>Accounting for Government Grants and Disclosure of Government Assistance</i> (includes interpretation NZ SIC 10)	No previous standard on this subject	NZ IAS 20 does not apply to public benefit entities. I am pleased about this, given it would otherwise result in misleading financial statements being produced by many public benefit entities.  I am of the view that NZ IAS 20 is a poor quality standard, and I support its non-application to public benefit entities.

NZ IFRS standard	Previous standard	Comments
NZ IAS 21 <i>The Effects of Changes in Foreign Exchange Rates</i> (includes interpretation NZ SIC 7)	FRS-21 <i>Accounting for the Effects of Changes in Foreign Currency Exchange Rates</i> and SSAP-21 <i>Accounting for the Effects of Changes in Foreign Currency Exchange Rates</i>	NZ IAS 21 includes no major changes from previous standards relating to the translation of transactions in foreign currency. However, there are some changes relating to translation of amounts recorded by foreign entities.  In general, I am not aware of any concerns with this standard for the public sector.
NZ IAS 23 <i>Borrowing Costs</i>	No previous standard on this subject, but requirements relating to borrowing costs were included in FRS-3 and FRS-4	NZ IAS 23 currently includes an option about borrowing costs for public benefit entities. Borrowing costs can be capitalised as part of the cost of a construction project or recognised as an expense. Having the option aligns with the requirements included in previous standards.  The option has only recently been reinstated for public benefit entities after protracted correspondence between the Accounting Standards Review Board and me.
NZ IAS 24 <i>Related Party Disclosures</i>	SSAP-22 <i>Related Party Disclosures</i>	NZ IAS 24 includes more disclosures for related-party transactions, a generally positive requirement in the public sector.  However, the exemptions relating to unnecessary disclosures need revision. Exemptions are subject to reconsideration by the Financial Reporting Standards Board.
NZ IAS 26 <i>Accounting and Reporting by Retirement Benefit Plans</i>	FRS-32 <i>Financial Reporting by Superannuation Schemes</i>	NZ IAS 26 includes no major changes from previous standards.  NZ IAS 26 affects very few entities in the public sector.  The Financial Reporting Standards Board is currently looking at whether to recommend withdrawing NZ IAS 26.

NZ IFRS standard	Previous standard	Comments
NZ IAS 27 <i>Consolidated and Separate Financial Statements</i> (includes interpretation NZ SIC 12)	FRS-37 <i>Consolidating Investments in Subsidiaries</i>	NZ IAS 27 includes less direct guidance on the crucial concept of “control” than was contained in the previous standard. However, public benefit entities are still required to follow relevant paragraphs from FRS-37 to decide if they control another entity.  The International Accounting Standards Board proposed a new standard on group financial statements at the end of 2008. The Financial Reporting Standards Board plans to adapt that standard for public benefit entities and remove the requirement for those entities to follow relevant paragraphs from FRS-37.
NZ IAS 28 <i>Investments in Associates</i>	FRS-38 <i>Accounting for Investments in Associates</i>	NZ IAS 28 has a narrower scope than the previous standard, but provides more flexibility about when equity accounting should apply.
NZ IAS 29 <i>Financial Reporting in Hyperinflationary Economies</i> (includes interpretation NZ IFRIC 7)	No previous standard on this subject	NZ IAS 29 is not expected to be relevant to New Zealand.
NZ IAS 31 <i>Interests in Joint Ventures</i> (includes interpretation NZ SIC 13)	SSAP-25 <i>Accounting for Interests in Joint Ventures and Partnerships</i>	NZ IAS 31 has a wider scope than the previous standard in that it covers: <ul style="list-style-type: none"> <li>• jointly controlled operations;</li> <li>• jointly controlled entities; and</li> <li>• jointly controlled assets.</li> </ul> NZ IAS 31 also requires more disclosures.

NZ IFRS standard	Previous standard	Comments
NZ IAS 32 <i>Financial Instruments: Presentation</i> (includes interpretation NZ IFRIC 2)	FRS-31 <i>Disclosure of Information about Financial Instruments</i>  FRS-27 <i>Right of Set-off</i>  FRS-26 <i>Accounting for Defeasance of Debt</i> and  FRS-21 <i>Accounting for the Effects of Changes in Foreign Currency Exchange Rates</i>	NZ IAS 32 includes some changes from previous standards, particularly about what is a liability and consequently what is recognised as equity.  NZ IAS 32 includes no changes from IAS 32 for public benefit entities. As a consequence, the standard is difficult to apply to some transactions commonly found in the public sector (for example, suspensory loans).
NZ IAS 33 <i>Earnings per Share</i>	No previous standard on this subject	NZ IAS 33 has limited applicability in the public sector because it applies only to listed entities such as port companies.
NZ IAS 34 <i>Interim Financial Reporting</i> (includes interpretation NZ IFRIC 10)	FRS-24 <i>Interim Financial Statements</i>	NZ IAS 34 includes no major changes from the previous standard, but more disclosures are now required.
NZ IAS 36 <i>Impairment of Assets</i>	No previous standard on this subject, but requirements relating to impairment of property, plant, and equipment were included in FRS-3 <i>Accounting for Property, Plant and Equipment</i>	NZ IAS 36 has a wider scope.  The standard has sensibly been amended in relation to non-cash-generating property, plant, and equipment. However, the amendment is not clear for the impairment of some other non-cash-generating assets.
NZ IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i> (includes interpretations NZ IFRIC 1, NZ IFRIC 5, and NZ IFRIC 6)	FRS-15 <i>Provisions, Contingent Liabilities and Contingent Assets</i>	NZ IAS 37 includes no major changes to the accounting requirements for provisions and contingent liabilities. However, there are changes to requirements for contingent assets.  The International Accounting Standards Board has proposed a new standard on non-financial liabilities to replace the standard about provisions, contingent liabilities, and contingent assets. The proposed standard contains significant changes from IAS 37.

NZ IFRS standard	Previous standard	Comments
<p>NZ IAS 38 <i>Intangible Assets</i> (includes interpretation NZ SIC 32)</p>	<p>FRS-13 <i>Accounting for Research and Development activities</i> and SSAP 3 <i>Accounting for Depreciation</i>  Also, there was a previous exposure draft, ED-87 <i>Accounting for Intangible Assets</i></p>	<p>NZ IAS 38 broadens the scope from previous standards, which were focused on research and development.</p> <p>NZ IAS 38 requires recognition of intangible assets but only if there is a reliable cost. That requirement can be a problem for public benefit entities receiving intangible assets for nil or a nominal amount.</p> <p>NZ IAS 38 does not address public sector intangible asset issues such as the creation of radio spectrum licences, fishing quota, and emission trading units.</p>
<p>NZ IAS 39 <i>Financial Instruments: Recognition and Measurement</i> (includes interpretations NZ IFRIC 9 and NZ IFRIC 16)</p>	<p>No previous standard covering recognition and measurement of financial instruments</p>	<p>NZ IAS 39 has had a major effect on financial reporting by all reporting entities. The main changes include:</p> <ul style="list-style-type: none"> <li>• recognition of all derivatives;</li> <li>• recognition of financial guarantees; and</li> <li>• initial recognition of all financial assets/financial liabilities at fair value.</li> </ul> <p>NZ IAS 39 is a complex standard that has had several amendments and adjustments since it was first put in place. NZ IAS 39 includes no changes from IAS 39 and includes no specific guidance for circumstances and transactions common to public benefit entities.</p> <p>Several important public sector issues (such as suspensory loans, low interest loans, and financial guarantees) are not adequately dealt with by the standard.</p> <p>Also, NZ IAS 39 does not deal with non-contractual instruments (such as tax and fines receivables) that are relevant to the public sector.</p>

NZ IFRS standard	Previous standard	Comments
NZ IAS 40 <i>Investment Property</i>	SSAP-17 <i>Accounting for Investment Properties and Properties Intended for Sale</i> and FRS-3 <i>Accounting for Property, Plant and Equipment</i>	NZ IAS 40 includes some changes from previous standards. For example: <ul style="list-style-type: none"> <li>• all changes in fair value are required to be recognised through the income statement; and</li> <li>• disposal costs are not deducted from the valuation of investment properties.</li> </ul> These changes do not appear to give rise to any particular concerns for the public sector.
NZ IAS 41 <i>Agriculture</i>	No previous standard on this subject. However, there was a previous exposure draft, ED-90 <i>Agriculture</i>	NZ IAS 41 is a new standard that requires agriculture assets to be revalued annually and for changes in value to be recognised through the income statement. The standard applies mainly to forestry assets in the public sector.  I am aware of some cost-benefit concerns with this standard for the public sector.
NZ IFRIC 12 <i>Service Concession Arrangements</i>	No previous standard on this subject	Although NZ IFRIC 12 is labelled as an interpretation, it does not interpret existing NZ IFRS because existing standards do not deal with the subject of accounting for service concession arrangements (also known as public private partnerships).  NZ IFRIC 12 sets out general principles relating to service concession arrangements for private sector operators. The interpretation does not specify the accounting by public sector entities responsible for specifying the nature of the service.  There is a need for authoritative requirements for public sector entities.
FRS-42 <i>Prospective Financial Statements</i>	FRS-29 <i>Prospective Financial Information</i>	FRS-42 is a standard created with all entities in mind (that is, the standard is sector neutral).  FRS-42 is not part of IFRS standards; nonetheless, it is part of NZ IFRS.
FRS-43 <i>Summary Financial Statements</i>	FRS-39 <i>Summary Financial Reports</i>	FRS-43 is an improved standard updated for NZ IFRS but largely in line with the previous standard.  FRS-43 is not part of IFRS standards; nonetheless, it is part of NZ IFRS.

## Appendix 2

# Other concerns about the suitability of NZ IFRS for the public sector

A2.1 This Appendix includes some specific implementation issues with NZ IFRS affecting public benefit entities, other than those reported in Part 4. These issues, in conjunction with the issues identified in Part 4, are not intended to represent a full list of implementation issues. Rather, they are included to show that there are many issues with NZ IFRS for public benefit entities. In my view, issues with implementing NZ IFRS are likely to continue emerging.

### Unnecessary disclosures about standards that do not yet apply

A2.2 NZ IFRS include a standard on accounting policies (NZ IAS 8).

A2.3 One of the requirements of NZ IAS 8 is to disclose information about new standards that have yet to be applied by the entity. Also, information that allows an assessment of the possible effect of new standards, when they are first applied, must be disclosed.

A2.4 Such disclosures are likely to benefit people using the financial statements of listed companies. Those people are more likely to be interested in comparing entities to help them with decisions about where to allocate resources.

A2.5 However, in my view, such disclosures are of little benefit to people using financial statements of most public sector entities. People using those entities' financial statements are more likely to be interested in accountability of the entities concerned. When it comes to comparability, comparing entities' results to forecasts is usually more important than any significant comparison with other entities.

A2.6 This unnecessary disclosure also adds costs. In my view, the people using the financial statements of most public sector entities do not need such information, therefore the requirement should be removed for public benefit entities.

### No guidance about ownership transactions without equity instruments

A2.7 In the private sector, transactions between entities and their owners are usually well defined. For example, a company normally issues shares to its owners when those owners invest in the company. From time to time, dividends are paid by the company to its owners, based on the number of shares the owners have.

A2.8 NZ IFRS have been based almost entirely on the above notions of ownership transactions. These notions are not relevant for most public benefit entities. Share certificates or other forms of equity instruments are not generally issued by public benefit entities in the public sector, and most of those entities do not pay dividends.

- A2.9 Throughout the public sector, there are many transfers of resources to and from “parent” entities and “subsidiary” entities. Because of the way the public sector is structured, many of these transactions occur through intermediaries. Therefore, it is not always clear whether the transfer of resources between parent entities and subsidiary entities are revenues or expenses, or contributions from, or distributions to, owners.
- A2.10 Given the nature of public benefit entities, I consider that NZ IFRS should include guidance to help identify ownership-type transactions in the public sector. I acknowledge that under previous standards similar issues existed. However, the previous Statement of Concepts for General Purpose Financial Reporting better dealt with the matter. I think it is reasonable to expect more guidance in this area, both in the NZ Framework and, where relevant, in standards.

### **No guidance about significantly influencing an entity without equity instruments**

- A2.11 NZ IAS 28 addresses the accounting for investments in associates. Associates are entities in which an investor has significant influence, but are not subsidiaries or joint ventures. Significant influence is defined as the power of an investor to participate in the financial and operating policy decisions of an entity, but without control or joint control over those policies.
- A2.12 NZ IAS 28 assumes the investor has a defined ownership interest in the associate. The interest is often defined by the number of shares the investor has in the associate. Alternatively, there may be an agreement that establishes an investor’s equity contribution and share of profit or loss of the associate, such as in a partnership agreement.
- A2.13 In the public sector, there are some public benefit entities that have together established an associate entity without defined ownership interests. Such associate entities typically carry out activities that are consistent with the objectives of the public benefit entities that established them. In my view, the establishing public benefit entities typically have an ownership interest in the associate entity, as that term is explained in NZ IFRS.
- A2.14 Usually each of the public benefit entities will be able to appoint people to the body that governs the associate entity. In this way, the public benefit entities can participate in the financial and operating policy decisions and, therefore, have significant influence over the associate entity.
- A2.15 I am concerned that NZ IAS 28 provides no guidance to public benefit entities about how to account for an associate entity in the situation described above.

Deficiencies in accounting lead to deficiencies in information for people who use the financial statements. I acknowledge that the point I raise existed in the previous standard. However, I believe it is reasonable that matters such as this one are dealt with by appropriate changes being made to NZ IAS 28.

### **Unclear whether price indices can be used for certain public sector asset revaluations**

- A2.16 NZ IAS 16 allows plant and equipment to be valued on the basis of readily available price indices that establish a reliable fair value. The paragraph in NZ IAS 16 that allows use of price indices is very similar to a paragraph in the previous standard, FRS-3. However, FRS-3 also contained further commentary that provided context for the use of price indices. The commentary made it clear that price indices could not be used where depreciated replacement cost was the basis for determining the fair value of plant and equipment.
- A2.17 Depreciated replacement cost is often used to arrive at the fair value of assets in the public sector. I am concerned that NZ IAS 16 does not provide context for the use of price indices, particularly where fair value is based on depreciated replacement cost.
- A2.18 I am aware that some entities in the public sector are interpreting NZ IAS 16 to mean that price indices can be used for depreciated replacement cost valuations. Those entities note that if the Financial Reporting Standards Board had intended NZ IAS 16 to result in the same treatment as FRS-3, the contextual commentary would have been added to NZ IAS 16.
- A2.19 I am not particularly comfortable with price indices being used for depreciated replacement cost valuations, because it means fair value is being derived without the appropriate involvement of an independent valuer. I suspect the exclusion of contextual commentary about the use of price indices from NZ IAS 16 was an oversight. In my view, NZ IAS 16 needs to be clarified to avoid unintended consequences either way, and to ensure that reliable information is included in financial statements for those people using them.

### **No guidance about how public benefit entities account for public private partnerships**

- A2.20 NZ IFRIC 12 is an interpretation that sets out the accounting for public private partnership arrangements by the private sector partner that operates an asset (subject to a service concession arrangement). The interpretation specifically notes that it does not apply to the public sector partner. The reason the

interpretation is limited to the private sector is because the interpretation on which NZ IFRIC 12 is based relates only to the operator of the service concession.

- A2.21 I am concerned that the scope of NZ IFRIC 12 does not address the accounting requirements for public private partnership arrangements by the public sector partner. By not addressing this possibility, different accounting treatments of such arrangements are more likely to occur, including that neither partner accounts for the assets underlying the partnership. Differences in accounting do not help people using financial statements to understand the public private partnership arrangements.
- A2.22 I am aware that the International Public Sector Accounting Standards Board is creating a standard to address accounting by the public sector partner in such arrangements. In my view, when the International Public Sector Accounting Standards Board has created such a standard, it should be used to create a New Zealand standard that sets out the accounting treatment for the public sector partner to these arrangements.

### **Difficulties assessing the fair value of non-commercial equity investments**

- A2.23 NZ IAS 39 requires equity investments to be recorded at fair value just like all other financial instruments. Where fair value is not readily attainable, valuation techniques can be used. When fair value cannot be reliably worked out using valuation techniques, the standard allows cost to be used.
- A2.24 Fair value for non-commercial equity investments is usually difficult to work out. These difficulties compound when equity investments are in public sector entities that are not traded and not intended to generate net cashflows. In these situations, commercial valuation techniques are likely to be meaningless.
- A2.25 I am concerned that NZ IAS 39 does not take into account typical non-commercial equity investments in the public sector. In my view, public benefit entities should not have to default to recording such investments at cost (which is less useful information to most people) simply because a commercial fair value as envisaged by the standard cannot be worked out.
- A2.26 I am sure there are other approaches for determining a fair value for such investments. For example, allowing the net assets of the equity investment to be used as a proxy for its fair value. Such a value would be better than cost, particularly where the assets and liabilities of the entity approximate fair value.

### **Inconsistent accounting for investments received without paying for them**

- A2.27 In the public sector, it is common for different types of assets to be received by public benefit entities without those entities paying for the assets (or only paying a nominal amount).
- A2.28 NZ IAS 16, the standard on property, plant, and equipment, requires property, plant, and equipment received for nil or a nominal amount to be initially recorded at fair value. That requirement relates only to public benefit entities. Standards related to investment assets such as subsidiaries (NZ IAS 27), associates (NZ IAS 28), and joint ventures (NZ IAS 31) do not contain that requirement.
- A2.29 Those standards require such investments to be accounted for, either at cost or fair value. Therefore, where there has been nil or a nominal payment, entities are allowed to account for the investment at cost (that is, nil or the nominal amount). In my view, nil or the nominal amount is not particularly relevant for those people using the resulting financial statements.
- A2.30 I consider NZ IFRS should be amended for public benefit entities to ensure that accounting for such investments is relevant to people using those entities' financial statements. The amendments should align the accounting for investments received for nil or a nominal amount with the accounting requirements for property, plant, and equipment received for nil or a nominal amount.

### **Difficulties determining when an entity's investment in a public benefit entity deteriorates**

- A2.31 NZ IFRS include a standard on impairment (or deterioration in value) of assets (NZ IAS 36). The scope of NZ IAS 36 includes financial assets, such as investments in subsidiaries, associates, and joint ventures.
- A2.32 Impairment of investments in subsidiaries, associates, and joint ventures is an important matter for the separate financial statements of a parent entity. Sometimes it can be difficult to work out if there has been impairment. Such difficulties arise where a public benefit entity has investments in subsidiaries, associates, and/or joint ventures that are also public benefit entities.
- A2.33 To find out if there has been impairment, the standard requires the recoverable amount of the investment to be worked out. Where an investment is not cash generating, such as investments in public benefit entities, the depreciated replacement cost of the investment is often a proxy for the recoverable amount.

- A2.34 A difficulty arises when applying the notion of depreciated replacement cost to investments in public benefit entities. This is because depreciated replacement cost is designed primarily to be used for property, plant, and equipment assets, not all types of assets.
- A2.35 I am concerned that the standard is difficult to apply to these types of investments. In my view, the standard should be amended to clarify how depreciated replacement cost can apply to these investments. Alternatively, the standard should use a basis other than depreciated replacement cost for calculating the recoverable amount of these investments.

#### **Unclear whether group financial statements are required when an entity influences but does not control other entities**

- A2.36 Occasionally in the public sector, an entity will not have any subsidiaries but will have an associate entity or entities. The legislation under which most public sector entities prepare financial statements requires both parent and, where applicable, group financial statements.
- A2.37 I find NZ IFRS unclear about whether an entity with no subsidiaries (but with an associate entity) is both a parent entity and, when combined with its associate entity, a group entity. In other words, it is unclear whether the entity needs to prepare both parent and group financial statements. I acknowledge that the point I raise is not limited to the public sector.
- A2.38 FRS-38, a previous standard, included helpful guidance for entities with no subsidiaries but with associate entities. That guidance noted that the entity could choose to account for its associate entities in its parent financial statements using the equity method, or it could prepare a separate set of financial statements that used the equity method to account for the associate entities.
- A2.39 I do not know why this helpful guidance was not included in NZ IFRS, at least for public benefit entities.

#### **No guidance about how to account for a public sector capital charge**

- A2.40 NZ IAS 32 requires interest, dividends received, losses, and gains relating to financial instruments to be recognised as income or expense. The standard also requires distributions (such as dividends paid) to holders of an equity instrument to be recognised as a reduction in equity. This means that the classification of a financial instrument as an asset, liability, or equity determines where interest, dividends, losses, and gains are recognised.

- A2.41 Capital charges are a cost imposed on many public benefit entities to:
- make transparent the full costs of the goods and services they produce (in particular, costs associated with financing capital); and
  - provide information and incentives for efficient management of the Government's investment in public sector entities.
- A2.42 Typically, a capital charge is based on an assumed debt-to-equity ratio. However, public sector entities tend not to have either debt instruments or equity instruments, which means the guidance in NZ IAS 32 is not directly helpful.
- A2.43 I am concerned that NZ IAS 32 could be interpreted to mean that the capital charge is not an expense of the entity. In my view, reporting the capital charge other than as an expense would thwart the purpose for the charge (that is, to ensure that the costs of capital are included "in the costs of services"), and adversely affect the relevance of financial statements to people using them.
- A2.44 I consider NZ IAS 32 needs to explicitly recognise capital charges and provide guidance about how such charges are to be accounted for.

#### **No guidance about accounting for use of Crown-owned property**

- A2.45 It is reasonably common for a public sector entity to have a right to use or occupy property owned by another entity. For example, state schools have a right to occupy land and buildings owned by the Crown. The arrangements in place between such entities typically are not leases as defined in NZ IAS 17. Also, the standard on intangible assets, NZ IAS 38, is not helpful about how to sensibly account for such arrangements.
- A2.46 I am concerned that accounting for these types of arrangements is not adequately addressed in NZ IFRS. In my view, the lack of guidance for these common types of public sector arrangements can lead to inconsistencies in accounting treatment. To remove such inconsistencies throughout the public sector requires effort from my Office. There would not be the need for that effort if NZ IFRS adequately addressed the issue.
- A2.47 FRS-3, a previous standard, included helpful guidance about accounting for arrangements where an entity had a right to use or occupy property. The guidance related to such arrangements where the benefits from the right to use or occupy property were substantially the same as if the property were owned. FRS-3 noted that the principles relating to accounting for physical assets, such as property, could be applied to the accounting for these rights.

- A2.48 I do not know why this helpful guidance was not included in NZ IFRS for public benefit entities.

### **Unclear how the Government should account for intangible assets it creates**

- A2.49 The adoption of NZ IFRS resulted in New Zealand getting a financial reporting standard (NZ IAS 38) that addressed intangible assets. Previously there was not a standard that broadly addressed intangible assets, therefore entities referred to the Statement of Concepts for General Purpose Financial Reporting. NZ IAS 38 includes few changes from IAS 38 for public benefit entities.
- A2.50 I am concerned that NZ IAS 38 does not include changes to deal with the type of issues encountered by governments when accounting for intangible assets. Governments establish rights such as fishing quota, radio spectrum licences, and emission trading units. These rights are intangible assets. However, NZ IAS 38 does not address how the Government should account for such rights, including any of those rights that the Government retains and uses.
- A2.51 In my view, NZ IAS 38 needs to include requirements and/or guidance to clarify how the Government should account for intangible assets that it establishes, so as to provide relevant information to people using the financial statements of the Government.

### **Inappropriate accounting for intangible assets received without paying for them**

- A2.52 Public benefit entities in the public sector commonly receive assets without paying for them (or paying only a nominal amount). Property, plant, and equipment assets received without paying for them, or paying a nominal amount, must be initially recorded at fair value. Intangible assets are another type of asset that can be received for nil or a nominal payment.
- A2.53 However, NZ IAS 38 requires all intangible assets to be initially accounted for at cost. Further, it limits the circumstances in which intangible assets can be revalued to such an extent that nearly all such assets cannot be revalued. Where an intangible asset has been received for nil or a nominal payment, I am concerned about the asset being recorded at nil or a nominal amount. In my view, nil or a nominal amount is not particularly relevant information for people using the financial statements.
- A2.54 I consider amendments should be made to NZ IAS 38 for public benefit entities to ensure that accounting for intangible assets is relevant to people using financial

statements. The amendments should align the accounting of intangible assets received for nil or a nominal amount with the accounting requirements for property, plant, and equipment received for nil or a nominal amount.

### **Unclear which internally generated intangible assets public benefit entities can recognise**

- A2.55 NZ IAS 38 outlines the criteria that must be demonstrated before an intangible asset arising from development expenditure can be recognised. Those criteria are also relevant to assessing whether or not website costs can be capitalised, because the criteria are cross-referred to a specific interpretation about website costs (NZ SIC 32).
- A2.56 One criteria is that it must be probable the intangible asset will generate future economic benefits. That probability can be demonstrated by the existence of a market for the output of the intangible asset or the intangible asset itself. If the intangible asset is to be used internally, the probability that it will be useful needs to be demonstrated.
- A2.57 Although the NZ Framework equates future economic benefits with service potential for public benefit entities, it is open to interpretation whether service potential should be applied to the criteria in NZ IAS 38, and if so, how. In noting this lack of clarity, I am aware that the NZ Framework does not override any specific standard.
- A2.58 In my view, changes are needed to NZ IAS 38 for public benefit entities to ensure that accounting for intangible assets is relevant to people using financial statements. The changes need to clarify the application of the notion of service potential as part of the criteria for recognising an intangible asset that arises from development expenditure.

### **No guidance about common public sector issues with property disposals**

- A2.59 NZ IFRS 5 has particular accounting requirements for property assets that are for sale. The standard is clear that sales should be expected to be completed within one year, except where delays are beyond the seller's control.
- A2.60 In the public sector, property may be disposed of through the Treaty of Waitangi settlements process rather than a sale transaction. That process often takes a long time, so the property may not be disposed of within one year. It is not clear how such property should be dealt with, or indeed whether NZ IFRS 5 is applicable, given disposal of the property is not through sale.

- A2.61 NZ IFRS 5 is also prescriptive about the properties that can be considered “for sale”. The active marketing of the property is one of the criteria that must be fulfilled for a property to be considered “for sale”.
- A2.62 In the public sector, it is common for property to be subject to a “disposal of Crown land process” before it can be sold. That process means the property cannot be actively marketed. The process can take a long time, and sometimes more than one year.
- A2.63 I am concerned that the processes for both Treaty of Waitangi settlements and disposal of Crown land have not been taken into account in establishing NZ IFRS 5. That standard needs to be amended, or guidance added, to clarify how these common public sector issues are dealt with. In this way, the standard could be clear to those in the public sector who apply it, and lead to relevant information in financial statements for people using them.

### **Information about managing capital is irrelevant to most public benefit entities**

- A2.64 NZ IAS 1 requires an entity to disclose information that enables people that use its financial statements to evaluate the entity’s objectives, policies, and processes for managing capital.
- A2.65 Such disclosures make sense for profit-oriented entities. Those entities typically have share capital, and some are subject to capital requirements such as prudential capital adequacy provisions, or banking covenants.
- A2.66 However, I question the value of such disclosures by public benefit entities. As the requirement is currently written, it makes little sense both for those preparing and for those using the financial statements of public benefit entities.
- A2.67 Public benefit entities typically do not have equity instruments, or a notion of “capital”. A look at some disclosures made by public benefit entities as a result of this requirement generally shows information of no value. I am not surprised, because the requirement has little relevance to public benefit entities.
- A2.68 In my view, public benefit entities should be exempted from the disclosure requirement.

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