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Measuring

Remeasurements

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1 Introduction

The Public Finance Act 1989, as amended by the Public Finance Amendment Act 2004, provides that the Crown or an Office of Parliament must not incur expenses except as authorised by an appropriation or other statutory authority. However, remeasurements, as defined by section 2 of the Act, are not included in the meaning of expenses (s4). The purpose of this paper is to establish guidance for making judgments as to whether an item is a remeasurement or an expense requiring appropriation.

2 Objective of Excluding Remeasurements from Appropriations

Appropriations are the expression of Parliament's control over public expenditure. They permit government to incur expenses and undertake capital expenditure. While revaluation losses may be considered an expense, most revaluation losses occur through changing expectations over the economic benefits or obligations that are embodied in assets and liabilities. Such changing expectations represent an ownership risk that are a consequence of holding assets and liabilities, the acquisition of which has already been approved by Parliament.

Parliament has determined in the Public Finance Act that it is not necessary for the Crown or Offices of Parliament to seek approval of such changes. This recognises that Parliament has in fact little control over expectations of future prices or estimates, and that it should not operate as a barrier to determining the most accurate and fair value of assets and liabilities when revaluations are carried out.

However some revaluations do not occur under the circumstances described above. They occur because the Crown or an Office of Parliament pays more than fair value to acquire an item, by decisions or actions by the Crown or Offices of Parliament that directly impair the value of an asset or increase the value of a liability, because the economic benefit embodied in an asset is being consumed. Such value impairments are caused by the Crown rather than by other parties. To maintain its constitutional role, Parliament still needs to exercise appropriation control over such items and they have therefore been excluded from the definition of remeasurements in the Public Finance Act.

It is therefore important that when policy proposals are being considered that could impair the value of assets, or increase the value of liabilities, or where a transaction results in a loss, that the appropriation implications of any policy decision are acknowledged and managed.

A fundamental principle to be applied to expenses or capital expenditure is that it must not be incurred unless in accordance with appropriation or statutory authority. The second principle, given effect by the remeasurement provisions in the Act, is that where events not under the control of the Crown cause a reduction in the value of Crown net assets, it is not appropriate for the Parliament to require prior approval for such events. Applying these principles, where there is uncertainty, the hurdle for an expense to be assessed as a remeasurement needs to be high.

3 Legislative References

The objectives outlined above are expressed in s2. and s.4 of the Public Finance Act.

Section 2 defines re-measurement as:

> "remeasurements"
>
> means revisions of prices or estimates that result from revised expectations of future economic benefits or obligations that change the carrying amounts of assets or liabilities; but does not include –
>
> i. revisions that result from transactions or events (in the period) that give rise to the initial recognition of assets and liabilities in the reporting period; or
>
> ii. revisions that result from transactions or events directly attributable to actions or decisions taken by the Crown; or
>
> iii. expenses that arise from the consumption of assets during the reporting period; or
>
> iv. interest income or interest expenses."

Section 4 sets out the appropriation requirement:

> "The Crown or an Office of Parliament must not incur expenses or capital expenditure, except as expressly authorised by an appropriation, or other authority, by or under an Act.
>
> In this section, expense does not include an expense that results from a remeasurement of an asset or a liability …"

Section 2 defines the Crown as:

> "(a) … the Sovereign in right of New Zealand; and
>
> (b) includes all Ministers of the Crown and all departments; but-
>
> (c) does not include-
>
> (i) An Office of Parliament; or
>
> (ii) A Crown entity; or
>
> (iii) A State enterprise named in Schedule 1 of the State-Owned Enterprises Act 1986

4 Making Judgements on Remeasurements

4.1 Examples of Remeasurements

Determining what is a remeasurement is a matter for judgement. The critical criteria will usually be whether the remeasurement was caused by changing expectations about future economic benefits or obligations.

The following list provides examples of items that would generally meet the criteria to be considered a remeasurement.

- Physical asset devaluations caused by movements in the property or other markets, including those that impact on the operating statement
- Long Service Leave provision movements due to changes in discount rates or changes in actuarial estimates over future salaries or changes in expected retention rates due to changes in economic conditions. Note however that a change in estimate driven by a renegotiated collective employment contract would not be a remeasurement as this is not due to changing expectations but rather results directly from Crown decisions
- Fair value movements in any financial instruments caused by interest rate changes (fair value movements caused by movements in equity markets would also be remeasurements).
- The actuarial gains and losses component in defined benefit schemes such as the Government Superannuation Fund.
- Goodwill impairment due to external conditions changing (this only affects Vote Finance at present).
- Asset and liability movements due to foreign exchange movements
- Revisions to provisions after initial recognition following changes in economic forecasts (e.g. a change to the provision to meet Kyoto obligations because of a change in the discount rate or carbon price would be remeasurements, however specific government policy decisions affecting the provision, such as carbon tax and deforestation would not be remeasurements).
- Investment property devaluations (including commercial forests) caused by movements in the property or other markets

4.2 Losses on Sale or Disposal of Assets

If an asset is sold or disposed of for less than its economic value the difference between the two should be appropriated. Therefore, losses on sale or disposal of assets will not be remeasurements and accordingly will be expenses requiring appropriation.

Such losses can occur when:

a. the carrying value is more than the higher of the net realisable value or value-in-use (economic value) (i.e. an impairment)

b. the economic value is higher than the proceeds from sale or disposal

c. a combination of both factors above.

Both the examples below show situations where the economic value is higher than the proceeds from sale or disposal. In the case of example 2 the carrying value is also greater than the economic value and therefore there is also an impairment of the asset.

Example 1:

-	economic value	$170	
-	carrying value	$100	
-	proceeds from sale or disposal		$50
-	loss on sale (to be appropriated)		$120

Example 2:

-	carrying value	$100	
-	economic value	$80	
-	proceeds from sale or disposal		$50
-	loss on sale (to be appropriated)		$30
-	impairment (remeasurement not appropriated)[1]		$20

[1] In most cases such impairments are likely to be due to a devaluation caused by movements in the property or other markets which (see 4.1 of our guidance) would be a remeasurement not requiring appropriation, as shown here. However, if the impairment was caused by the Crown then the impairment would require appropriation.

Some assets, typically vehicles, plant and machinery, are generally not revalued as the benefit from doing so is lower than the cost. In such cases the carrying value is calculated by deducting accumulated depreciation from the cost, and is therefore a measure of the cost of the asset yet to be consumed or value-in-use. Where a decision is made to dispose of such assets at fair value, and the proceeds are below carrying amount this will therefore be because the calculated value-in-use is higher than the net realisable value. In such cases the Crown has made a decision that reduces economic benefits and therefore the loss is an expense and not a remeasurement. In such cases the loss on disposal is effectively under-depreciation.

The above is given effect by a combination of the requirements of the Public Finance Act and by Treasury Instructions. Paragraph 6.3.1.1 of Treasury Instructions states:

> “Section 4 of the Act requires all expenses to be incurred in accordance with an appropriation (or other statutory authority). Accordingly, if an expense is incurred by disposing or extinguishing of an asset for less than fair market value an appropriation is required. If the disposal is not related to production of outputs the appropriation required is an “Other Expense” appropriation (refer sections 2 and 7 of the Act).

Where an asset is reported at cost, the situation can arise where the difference between fair market value and the consideration received on disposal is not fully captured (if at all) as an expense under GAAP.

To avoid situations where such expenses are not recorded and appropriated, assets must be revalued to fair value prior to disposal if the disposal process will not result in a fair value being received. An Other Expense appropriation will then be required for the expense to be incurred, which will represent the difference between fair market value and consideration received from disposal. "

4.3 Distinguishing between Forgiveness, Provisions and Write-offs

The purpose of the provision is to alter the carrying amount of the loan portfolio down to its estimated recoverable amount. There is a difference however between a provision applied against a Crown asset to enable the asset to be reported at its recoverable amount, and the forgiveness or extinguishment of a Crown asset below its fair market value.

Debts can be forgiven. An appropriation is required when a decision is made to forgive an outstanding Crown debt because the resulting write-down or write-off results from transactions or events directly attributable to actions or decisions taken by the Crown.

Forgiveness of a loan occurs when the person or organisation is no longer required to repay the loan. For example if a decision is made that a particular group of students do not have to repay their student loans. Forgiveness can occur when a write-off is in-substance an actual extinguishment. For example where a department makes a provision and does not monitor or put in place any credit control and recovery programmes. This implies a deliberate decision not to collect the money that is owed.

In this case there will be a Crown asset in the form of a receivable/ loan/ advance which the department in its agency capacity will be required to actively monitor and seek recovery of on the Crown's behalf. If provision in-substance includes a forgiveness element, then that element would require an appropriation. Inaction in credit control and recovery could permanently impair the recoverable amount of the Crown's monetary asset.

Departments therefore need to be clear about their credit control policy and what the provisions actually represent. To make this easier, listed below is guidance on when a debt has been legally extinguished.

- Specific restructuring – for example the department has knowledge that the debtor is in financial difficulty and has restructured the loan with a reduction in the terms under the new loan agreement.
- Bankruptcy or Insolvency – the department or another creditor may have filed petitions under the Insolvency Act.
- Wind up – the department or another creditor may have filed petitions under the Companies Act.
- Statute Bar period – through lapse of time the debt has become irrecoverable or unenforceable by action. However, where a department has no intention to take the appropriate recovery actions on an outstanding debt, any provision against that debt may be an indication of forgiveness at that point.

Where departments have no credit recovery programme for outstanding debts, there is a strong argument that an appropriation should take place at the point the provision for doubtful debts is made. This is because while the debt outstanding has a fair market value above zero at that point in time, past departmental practice would indicate that no recovery action will occur and the debts will eventually lapse and therefore be forgiven.

As can be seen from the above, distinguishing between forgiveness, provisions and write-offs can be difficult and requires judgement to be exercised. In doing so, the principles identified in part 2 above should be borne in mind and where if is uncertainty, the appropriate treatment will be to treat the item as an appropriable expense.

4.4 Movements in Value of Working Capital Items

Inventory provisioning (except inventory that becomes obsolete due to action or decision – such as a decision to sell or replace one type of ship or plane) and provisioning for doubtful trade debtors could also be considered remeasurements, though movement in these items themselves is not. Practical difficulties will often exist in disaggregating any remeasurement of such items from other movements. For example, the re-assessment of a doubtful debtor provision could partially be the result of a review of department collection procedures, and partly a reassessment of the probability of their collection.

Because of such difficulties, departments and Offices of Parliament should treat all such movements of working capital items as expenses. This approach should be efficient, involving least compliance cost. Also it means that despite items being included in the request for appropriations that are not strictly necessary to bring Parliament's attention, no breach of the Act occurs.

4.5 Changes in Accounting Policy

Reductions in the value of assets or increases in the value of liabilities can be caused by changes in accounting policies and so the question is likely to arise as to whether a change in accounting policy should be considered a remeasurement.

In general, the remeasurement definition as specified will not capture changes in accounting policy. Usually a change in accounting policy is a changed means of measuring future economic benefits or obligations, rather than changes in expectations about the actual future economic benefits or obligations.

Also, a change in accounting policy is a decision that is made. Such items are specifically excluded from the definition of remeasurement. Further, it is appropriate that the changes in accounting policy, and the resulting impact are brought to Parliament's attention as part of its scrutiny process.

4.6 Initial Measurements and Remeasurements

While the concept in the Public Finance Act is "re"measurement – not initial measurement –this might be considered a disputable boundary (for example zero could be seen as initial measurement and new liability is the "re" measurement, as when the Long Service Leave liability was first recognised). In some cases Parliament does not have control of initial recognition, any more than it does over other remeasurements. By definition however these are not "re"measurements and the remeasurements provision should not be used in such cases.

5 Managing Remeasurements

5.1 Non-departmental Remeasurements

Given the allocation of the Government balance sheet, there will be likely to be more examples of non-departmental remeasurements than departmental remeasurements.

Key areas where non-departmental remeasurements could be expected to occur include some of the movements in student loans, IRD taxes receivable, MSD benefit debt and Justice debt (fines, etc). Clearly elements of the annual doubtful debt provision/bad debt write off movements will be due to remeasurements (discount rates when they are potentially introduced under IFRS, uptake assumption changes, repayment assumptions, etc), though a large portion of any increases is also due to the initial recognition of new doubtful debts (due to ongoing nominal growth in the underlying base receivables).

Because remeasurements do not require appropriation, they will not appear on the CFISnet non-departmental appropriation schedules. However to the extent they are required by GAAP to be treated as expenses, they will appear on the CFISnet non-departmental expense schedule. Remeasurements can therefore create a reconciliation difference between appropriations and GAAP expenses.[2]

However, where the remeasurement would be an expense under GAAP, there will be a difference between GAAP expenses and appropriated expenses. This difference needs to be reported in the CFISnet reconciliation schedule.

5.2 Departmental Remeasurements

Remeasurements do not, of themselves, cause any changes to Revenue Crown funding flows. Management of balance sheet movements are still required to be managed within existing funding levels.

While remeasurements are excluded from appropriations, they will not (always) be excluded from expenses as defined in GAAP. Therefore it is possible that a disjunct can occur between reported expenses per GAAP and appropriation expenses.

The common remeasurements within departments are likely to be physical asset devaluations, long service leave movements (due only to assumption changes) and any fair value movements from derivatives held. As noted above, movements in inventory and accounts receivable values due to reassessments of realisable value are not treated as remeasurements but rather are appropriated.

In the vast majority of cases these will not lead to a disjunct between GAAP and appropriations. However in case such an instance occurs this year, we intend to provide a departmental reconciling schedule in CFISnet for use from year end 30 June 2006.

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[2] Note that this will not always be the case as some remeasurements are not expenses under GAAP, as when a revaluation reserve covers the revaluation loss.

5.3 Revaluations That Are Not Remeasurements

Some revaluations are not remeasurements, but reduce the value of an asset or increase the value of a liability. Usually such revaluations are caused by direct decisions or actions that are proposed or taken at the Ministerial level. In general such items should be treated as any other accrual-based appropriation request and managed through the changes to baselines process. This may entail using imprest supply or managing the impairment decision so that it occurs as part of a budget update.

5.4 Realising Revaluation Gains and Losses

Unrealised revaluation losses (and gains), whether treated as a remeasurement or as an appropriable item, have the potential to be realised. If the item is an asset this will occur if the asset is sold or otherwise disposed of, if a liability, this will occur on its settlement.

The accounting treatment in the financial statements of departments or offices of parliament is not affected by whether a negative revaluation is treated as an appropriation or as a remeasurement. Therefore the calculation of the surplus or deficit does not change, nor do remeasurements affect the rules by which the calculation of the provision for repayment of surplus is made.

Departments and offices of parliament are responsible for managing the ownership risks associated with their balance sheet. There is no requirement to pay back revaluation gains made by departments or offices of parliament, nor is there a requirement on the Crown to reimburse departments or offices of parliament for revaluation losses suffered.