2007/08 Government Financial Statements – Additional Material

The 2007/08 Financial Statements of Government are the first to be prepared in compliance with New Zealand International Financial Reporting Standards (NZ IFRS). As such, they are different from those published in previous years. This handout provides some additional material explaining the rationale for the change to NZ IFRS, the impact on the numbers, and changes to presentation and disclosures.

First Audited Set of NZ IFRS compliant financial statements

What is NZ IFRS?

NZ IFRS stands for New Zealand Equivalents to International Financial Reporting Standards. International Financial Reporting Standards (IFRS) are produced by the International Accounting Standards Board and are becoming the standard for high-quality global set of financial standards aimed at servicing the needs of investors, particularly in the international capital markets. In New Zealand, large corporates fully comply with IFRS, and the Accounting Standards Review Board has approved a number of additional requirements relating to all entities mainly to fit with regulatory requirements, and in the case of public sector and not-for-profit entities a number of amendments to ensure that the particular needs of users of financial statements of these entities are met. An example of such requirements is additional guidance on how to account for assets that do not generate cash, such as the state highway network and military equipment. The resulting set of IFRS-based standards, approved as generally accepted accounting practice in New Zealand, are referred to as NZ IFRS.

Why did we change to NZ IFRS?

The Accounting Standards Review Board mandated this requirement, as they believed that adopting global financial reporting standards would improve the quality of financial reporting as IFRS is more comprehensive, more widely accepted and more robustly tested. In addition for New Zealand's corporate sector there is enhanced domestic capital market transparency and accountability.

The New Zealand Government has been required to comply with generally accepted accounting practice (GAAP) since the Public Finance Act of 1989, and therefore had to adopt NZ IFRS. Common financial reporting across sectors in New Zealand provides consistency and transparency to users of financial reports.

Other Governments' use of IFRS

The Australian Whole-of-Government financial statements comply with Australian Equivalents to IFRS (AEIFRS), which is very similar to NZ IFRS. The UK Government has announced a decision to prepare IFRS-based financial statements from 2010. Some other countries, notably Switzerland and South Africa are moving to adopt International Public Sector Accounting Standards, which are also primarily based on IFRS.

Impact of changing NZ IFRS on the fiscal indicators

The impact of applying the new standards on the numbers has been relatively small.

The impact of the transition was initially disclosed in the 2007 Budget, and is repeated in Note 33 of the financial statements for the year ended 30 June 2008. In 2007, the Operating Balance was $641 million or 7.4% lower under NZ IFRS than it would otherwise have been, while net worth was $991 million or 1.0% higher than it would have been. The differences were mainly caused by changes in the way the GSF retirement provision and the ACC outstanding claims liability are estimated.

Historical trend series information has been restated back to 1999 in the financial statements.

Impact in terms of Presentation and Disclosure

There is a lot more disclosure. The audited GAAP based section of the Financial Statements of Government for the year ended 30 June 2007 ran to some 60 pages. This year, the financial statements are 133 pages long.

The following provides information as to what that additional disclosure entails.

Main Statements

- The Operating Statement is fairly similar except that insurance expenses (ACC and EQC) are separated out as are gains and losses, both from financial instruments and non-financial instruments such as GSF and ACC provisions. These disclosures are expanded in the notes (12 and 13).
- In the Cash Flow Statement, gross rather than net flows from trading in marketable securities, shares etc are shown.
- Instead of a Statement of Movements in Equity (apart from movements in Air NZ shareholders, the Government doesn't have direct transactions with equity-holders) there is this year a Statement of Recognised Income and Expenses, which reports gains and losses not reported in the Operating Statement, such as from the revaluation of physical assets.

- The Statement of Financial Position (Balance Sheet) categories are fairly similar, although they are categorised by type rather than by source, thus retirement plan liabilities are mainly GSF, insurance liabilities relate mainly to ACC and EQC, and equity accounted investments are mainly Tertiary Education Institutions.

- Statements of Commitments, Contingent Liabilities and Accounting Policies are now all encapsulated as separate Notes to the Accounts.

- The Statement of Accounting Policies is now more detailed; fifteen pages instead of eight. More information is provided on the basis of preparation, our approach to early adoption of standards issued but not yet effective, more granularity on our accounting policies with respect to financial instruments in particular but also in other areas such as property plant and equipment.

Financial assets and liabilities

- Financial assets and liabilities exist where there is an agreement between the Government and another party to pay or receive cash (or another financial asset or liability). They include assets such as receivables, advances and investments, liabilities such as borrowings, and derivatives such as forward exchange agreements and options.

- Receivables (or debtors) include tax receivables, levies fines and penalties receivables (including Justice and ACC) social benefit receivables and trade receivables. There are considerably more disclosures on receivables (Note 14). We report separately the impairments that have been made, an analysis of current and past due receivables, an aging analysis, and where receivables are expected to be long-term, the discount rate used, and what the impact would be if that discount rate assumption was increased or decreased.

- Similar disclosures are made of advances (Note 17), such as student loans and Kiwibank mortgages. In the case of student loans we have also included a movements analysis for the year.

- A largely new note (Note 32) provides information to allow an evaluation of the significance of financial instruments (i.e. financial assets and financial liabilities) for the Government's financial position and the nature and extent of risks arising from those financial instruments to which the Government is exposed and how the Government manages those risks.

- In Note 32 we report that the Government has devolved responsibility for the financial management to its sub-entities including NZDMO, RBNZ, IRD, NZSF, ACC, NZ Post, Air NZ, EQC, Transpower, Customs, MSD, Mighty River, Meridian and Genesis. We report on the size of each of these portfolios (they all exceed $1 billion of either financial assets or financial liabilities) and the significant accounting policies applied. We report on the classes and categories of these assets and how we have designated them for financial measurement and reporting purposes. We describe the portfolio management practices to manage market risks and the derivative instruments used to manage exposure to interest rate risk, foreign currency and electricity price risks.

- We report the carrying value and notional value of derivatives that are in gain and in loss at balance date, and we separate out those derivatives that hedge movements in fair value, from those that hedge cash flows. With respect to interest rate risk management we report the periods when cash flow subject to hedge accounting are expected to occur, and we provide a sensitivity analysis showing the impact on the operating balance and net worth, had interest rates been 100 basis points higher or lower at balance date. With respect to foreign exchange risk we report which currencies financial instruments are denominated in, and the impact on the operating balance and net worth if the New Zealand exchange rate strengthened or weakened by 10% across the board. We note that the Government's sensitivity to foreign currency has increased during the current period mainly due to the financial instrument portfolios held by NZDMO, RBNZ and ACC. We report on the impact a 10% fall (or rise) in share prices would have on the operating balance and net worth. We report on our own credit rating, on concentrations of credit exposure classified by credit rating, geography and industry of the counterparty and we summarise the credit risk management policies of the main portfolio managers. Finally, to illustrate our liquidity risk management we report on the contractual maturity of liabilities.

New Note Information

- Many of the notes now provide a breakdown into sub categories and a separate analysis "by source" – which shows how much of the item (say personnel expenses) arises in Core Crown, Crown entities or State-owned enterprises.
- The tax note (Note 2) has not changed.
- In the transfer payments note (Note 6) we now have a separate section for subsidies, given the $1,102 million Kiwisaver subsidy.
- Ministers of the Crown are considered key management personnel, and their personnel costs are disclosed (Note 7), along with a statement that other transactions they and their families had with the Crown did not affect the financial position or operating balance of the Government
- More detailed disclosure are provided of audit fees, audit related fees etc (Note 9)
- The notes analyse finance expenses as to the types of financial liabilities they relate to, and in the case of provisions measured at net present value, the amount of discount unwind that has occurred during the year (note 10).
- A new note (Note 11) analyses insurance expenses, including claims, reinsurance expense, movements in unexpired risk liabilities and actuarial gains. The net underwriting result is also disclosed.

- The Property Plant and Equipment note (Note 20) is considerably expanded. Each class of PPE now contains a movements analysis, reporting the impact of acquisitions, disposals, depreciation, revaluation etc. during the year. Valuers are named, and the approach and timing of each valuation is reported.

- A new borrowings note (Note 23) reports the types of borrowings, where they are held, and maturity. Where borrowings have been fair valued, there is information on the approach and assumptions used. In the case of finance leases, minimum lease payments are reported in both nominal and present value terms.

- Considerably more information is provided on insurance liabilities, particularly the long-tailed ACC liability (Note 24). We report on unearned premiums, and their adequacy to meet expected claims for the period those premiums received cover. In the case of outstanding claims, the central estimate, the risk margin and what the risk margin covers is reported. We provide an analysis of claims development (going back just two years this year, although it will eventually go back five years). We provide information on the key assumptions used such as discount rates, medical inflation, case management of the tail of claims, and a sensitivity analysis of the impact if the actual result is different to those assumptions.

- Similarly there are increased disclosures about the GSF obligation (Note 25). We report on the nature of the scheme, the actuarial method applied, the present value of the total obligation, the fair value of the plan assets, and the movements in both of these amounts during the year. We report where pension costs are recognised in the operating statement (personnel expenses, and gains/losses in non-financial instruments). The assumptions used in the actuarial calculation, and the impact of changes to those assumptions are reported. We report on where the plan assets are held, and we provide a historical analysis, which shows the annual experience adjustments necessary between actuarial assumptions and actual results.

- We report on our "capital objectives" which we have interpreted as our fiscal policy and progress against those objectives (Note 28).

- A new note, similar to that appearing in the Budget reports on the impact of adoption of NZ IFRS (Note 33). This note will be a one-off, disappearing next year.

- Finally, although not related to the introduction of NZ IFRS, there is one other addition note this year, reporting a significant subsequent event; the acquisition of KiwiRail from Toll Holdings (Note 34).

Additional information on the Financial Statements of Government …

… can be found on the Treasury website at:
http://www.treasury.govt.nz/government/financialreporting