Eliminations Framework for the Financial Statements of the Government under NZ IFRS

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Introduction

The Government reporting entity comprises Departments, Offices of Parliament, Crown entities (CEs) and state-owned enterprises (SOEs) including Air New Zealand. The accounts are presented segmentally on the basis of:

- Core Crown (including Departments, NZS Fund and the Reserve Bank)
- State-owned enterprises
- Crown entities.

Revenue and expense flows, asset and liability balances (including financial instrument transactions), and cash flows between and within these segments (e.g. department to department, department to SOE, and department to CE) need to be identified and eliminated. This document provides a framework and rules for identifying and agreeing these flows and balances. This document, in conjunction with the Schedule Line Dictionary, helps Crown Reporting Entities complete their CFISnet DataLoads and accompanying information.

Rationale for Framework

In determining the level of elimination information required under NZIFRS, the aim was to establish a practical framework that focused on:

- Minimising changes to existing practices that are working well, e.g. current eliminations collected since 2002.
- Low compliance costs and dual reporting requirements.
- Materiality considerations.
- The need to obtain a level of certainty over the flows and balances (i.e. they need to balance).
- Minimising “difficult to collect” eliminations, particularly those for which entities were unlikely to have an existing General ledger code, such as EQC insurance premiums, motor vehicle levies, and fire service levies.
- The need for a residual “general rule” for inter-entity transactions (i.e. include all inter-entity transactions over $1 million p.a.).
- Confirmation for all balances and transactions greater than $10 million with another Crown reporting entity (i.e. Crown, department, SOE or Crown entity).

The Framework

The framework is presented in a table overleaf. The impact of applying the framework on transactions is:

- When reporting to Treasury, Crown reporting entities need to distinguish in their DataLoad between transactions with the Crown, departments, SOEs, Crown entities and 3rd parties. All Crown Reporting Entities subject to this elimination framework are listed in the annual financial statements of the Government (these are available at www.treasury.govt.nz/financialstatements/archive.asp)
- All flows and balances between departments and between departments and the Crown are to be separately identified (step 1)
- All funding (including capital contributions) from the Crown to Crown Entities and SOEs are to be separately identified (step 1), as are dividend flows back to the Crown
- Individual entities can value financial instruments according to the accounting policies adopted by these individual entities. However, there are some designation restrictions for inter entity financial instruments when reporting to Treasury: the held to maturity designation is not permitted, hedge accounting with inter entity financial instruments is not permitted, and the available-for-sale designation is permitted for government securities (government stock and Treasury bills) only
- For certain financial instrument transactions, an elimination spreadsheet is to be provided along with every CFISnet submission

Step 1. Identify regardless of size:

- Funding flows between the Crown and departments (Revenue Crown) and between the Crown and Crown entities and SOEs (e.g. Ministry of Health payments to District Health Boards , Ministry of Education payments to schools)
- Capital contributions between Crown reporting entities
- Dividend flows between Crown reporting entities
- All inter-department or department to Crown assets/liabilities, revenues/expenses or cash flows (e.g. Revenue Department activities, audit fees, GST receivable)
- Tax expenses and balances (e.g. deferred tax liabilities, GST receivable, SSCWT expense)
- Air NZ expenses
- TVNZ expenses
- NZ Post expenses
- Expenses for electricity services provided by energy SOEs[1] (i.e. where the relationship is one of energy supplier and energy customer. All other commercial transactions with or between energy SOEs should be reported in accordance with step 4)
- ACC employer levies
- GSF expenses

Step 2. Specifically exclude from elimination lines (i.e. treat as though 3rd party transactions):

- Motor Vehicle registration fees, NZ Fire Service levies, EQC premiums and ACC motor vehicle premiums
- Transactions to another Crown entity or SOE via a third party except for Air NZ travel through a travel agent (see notes)
- ACC earner premiums and PAYE

Step 3: Separately disclose inter-entity financial instrument transactions

Financial instrument transactions and balances with other Crown reporting entities greater than $1 million must be disclosed in the appropriate inter-entity elimination line. Additional information is required in some instances, as identified below (and see notes), to support elimination entries.

Loans and advances for elimination

- Inter-entity loans and advances refer to non-marketable securities negotiated

[1] Energy SOEs in this context refer to Genesis, Meridian, and Mighty River Power

between two Crown reporting entities. For example, loans issued by NZDMO to Crown entities and ECNZ loans to electricity entities. For elimination purposes, both the lender and borrower should disclose these as inter-entity transactions and balances (i.e. there will be a 1-to-1 match on elimination).

- The expectation is that pricing differences between reported values to be eliminated on these instruments should be small.

Marketable securities for elimination

- Inter-entity marketable securities refer to instruments that <u>may</u> be issued or on-sold without the issuer necessarily knowing who holds the security. For example holdings of Government stock and Treasury bills and any marketable debt issued by SOEs or Crown entities.
- Holders of the security need to separately identify marketable securities held that have been issued by another Crown reporting entity. Issues of the security would report these securities as transactions with 3rd parties.
- In addition, entities are required to complete the monthly elimination spreadsheet (see notes) for inter-entity marketable security balances.

Equity investments for elimination

- Equity investments in Air New Zealand, whether held directly or via a fund manager, need to be reported in the appropriate DataLoad line. Holders of equity investments in Air New Zealand are also required to complete the monthly elimination spreadsheet (see notes).
- Equity investments of more than 5% held in any other entity is to be disclosed annually, regardless of whether it is owned by the Crown, through fund managers or direct investment. This information is required in order that significant influence or control over an entity can be evaluated. This additional information will be collected outside the DataLoad and for annual reporting only.

Derivatives for elimination

- For electricity derivatives, specific lines exist in the DataLoad to identify the other entity involved in the derivative
- Entities are required to complete the monthly elimination spreadsheet (see notes) for derivative balances greater than $1 million.

Step 4: All other inter-entity transactions:

- All other inter-entity assets/liabilities, revenues/expenses or cash flows if expected to be >$1 million per annum with a Crown reporting entity.

Include amounts less than $1m during the year if the annual amount is expected to be greater than $1m, e.g. $0.8m in May and $1.2m in June.

Treat each financial statement separately. If an expense with a Crown entity is expected to be over $1m pa, disclose it as a Crown entity expense. If the corresponding creditor is expected to be less than $1m during that year, exclude it (i.e. disclose it in accounts payable to 3rd parties).

The text columns should be used to identify the Crown reporting entity that has the other side of the transaction or balance.

Step 5: Confirmations between Crown reporting entities are required if:

- Assets or liabilities, revenues or expenses or cash flows with a particular entity exceed $10 million. This does not include tax flows, Crown funding to departments, Air NZ expenses, TVNZ expenses, NZ Post expenses, electricity expenses, and ACC employer levies
- Where measurement bases differ for the same transaction (e.g. a debt is valued at amortised cost whereas the related loan asset is fair valued) entities need to ensure that differences in reported values relate only to different measurement approaches. For example, nominal values and volumes may need to be confirmed for material balances and transactions if reported values do not provide a good basis for confirmations.

The onus is on the entity receiving the revenue or holding the asset to ensure the amounts are confirmed. These confirmations do not need to be provided to Treasury (although explanation of the confirmation process may be requested if balances do not agree)

Additional Notes

Step 1: Identify regardless of size

As systems are well established to report Crown funding flows and transactions between departments, all such transactions will continue to be captured for elimination purposes. Capital contributions and dividend flows between the Crown and Crown reporting entities are to be identified regardless of size.

The remaining transactions in this section (e.g. Air NZ expenses, NZ post expenses) are characterised by many individual entities having expenses to one supplier (e.g. postage stamps purchased from NZ Post). For these items, the purchaser should report all transactions in the appropriate elimination line. The supplier should report revenue from these transactions as though they were from 3rd parties, regardless of whether they know it is an inter-entity transaction.

NZ Post transactions

When disclosing NZ Post expenses, please exclude any 3rd party courier or postal costs that you may be reporting within the same GL account line (to a reasonable degree of accuracy). This includes "Gallaghers mail services" which provides postal services for a number of large entities.

Please include transactions with the following companies, which form part of NZ Post Group:

- NZ Post
- NZ Post Properties
- Express Couriers (includes CourierPost, PACE, Contract Logistics)
- Letterbox Channel (formerly Kiwimail)
- Datamail (includes Communication Arts Ltd)
- KiwiBank (includes Kiwi Insurance Ltd)

Air New Zealand transactions

Transactions with any company within the Air New Zealand group should be treated as an inter-entity transaction with Air New Zealand. These include:

- Air Nelson Limited
- Air New Zealand Destinations Limited
- Mount Cook Airline Limited
- Safe Air Limited
- Eagle Air Limited

- Freedom Air Limited

Travel booked through a travel agent is to be included as if the transaction is with Air New Zealand (which it effectively is as travel agents are generally acting as a direct agent for Air New Zealand – this differs from the circumstances outlined in Section 3 and the notes below; materiality is also a factor).

Step 2: Specific exclusions

Most of the items in this section are excluded due to cost/benefit considerations, based on feedback from entities.

A general exclusion is provided for transactions where one entity is transacting with another entity within the Crown via a third party. An example is where entities pay Saatchi & Saatchi for advertising, which then involves a transaction between Saatchi & Saatchi and TVNZ. This general exclusion does not apply to companies, which are Government owned subsidiaries, for example the NZ Post subsidiaries noted above or the purchase of Air New Zealand services through a travel agent.

Step 3: Separately disclose inter-entity financial instrument transactions

A financial instrument elimination spreadsheet is available on CFISnet's Homepage. This spreadsheet captures information not collected in CFISnet as specified in step 3. The spreadsheet format is used as it provides greater flexibility to customise and update the data as required.

Step 4: All other inter-entity transactions

Specific operating statement lines have been included in CFISnet schedules for balances, expenses and flows between Crown reporting entities that are expected to exceed the annual $1 million threshold.

Please be strict about applying the $1 million cut-off rule even if transactions with SOEs and Crown entities can be easily identified.