Treasury Instructions 2010

The only official version of the Treasury Instructions appears on the Treasury's website at http://www.treasury.govt.nz/publications/guidance/instructions. If you download this file, it is your responsibility to regularly check the Treasury's website to ensure that changes have not been made to the Treasury Instructions.

1 July 2010

Treasury Instructions are issued under Section 80 of the Public Finance Act 1989.

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1 Introduction to Treasury Instructions

1.1 General

This document comprises:

(1) a summary of the of the relevant provisions of the Public Finance Act 1989 (the Act);

(2) a set of instructions in **bold** to be known as Treasury Instructions (the Treasury Instructions); and

(3) some guidance on the Instructions and the provisions of the Act.

The Treasury Instructions are issued under the authority of section 80 of the Act and are to be read in conjunction with the Act (all terms have the same meaning as in section 2 of the Act).

1.2 Date of issue

The Treasury Instructions contained herein were issued on 30 June 2010, and apply as from 1 July 2010. All previous Treasury Instructions applying to departments as defined in the Act are hereby revoked.

1.3 Structure of Treasury Instructions

This document comprises six sections:

Section one: Introduction to the Treasury Instructions.

Section two: Principles for the development of accounting policies for external financial reporting. This section of the Treasury Instructions is to be complied with by the Government and departments when developing accounting policies for external financial reporting.

Section three: Accounting policies for external financial reporting by the Government of New Zealand. This section of the Treasury Instructions is to be complied with when providing reports on Crown revenue, expenditure, assets or liabilities, and when providing information for the preparation of the Financial Statements of the Government of New Zealand and Forecasts.

Section four: Accounting policy parameters for external financial reporting by departments. Departments must select their accounting policies within the parameters specified in this section of the Treasury Instructions.

Section five: Cost accounting policy parameters. Departments are required to provide a clear and concise statement of cost accounting policies in external financial reports, and this section of the Treasury Instructions provides criteria for disclosing cost accounting policies.

Section six: Operating instructions. This section of the Treasury Instructions is to be complied with when determining and operating departmental accounting and management systems.

A number of publications have been developed to assist departmental Chief Executives with the development and maintenance of appropriate accounting policies and systems. Departments can obtain these publications through the Treasury web site www.treasury.govt.nz.

1.4 Application of Treasury Instructions

The Treasury Instructions apply, subject to the provisions of the Act and of any regulations made under the Act, to all Chief Executives and all employees of any department as defined in the Act. It is the responsibility of every Chief Executive to ensure that the Treasury Instructions are complied with.

1.5 Access to Treasury Instructions

The current and only official version of the Treasury Instructions is on Treasury's web site (www.treasury.govt.nz).

Chief Executives are to ensure that all employees have sufficient access to the Act and to the current Treasury Instructions issued under the Act.

1.6 Review of Treasury Instructions

The Treasury Instructions are reviewed and updated annually. They are effective from 1 July of the year in which they are published. Each new version of the Treasury Instructions issued in this manner supersedes all previous versions of the Treasury Instructions.

1.7 Changes since last update

The changes to the Treasury Instructions since the previous version (1 July 2009) are:

- Section 1.8 Relationship between Treasury Instructions and Treasury Circulars: Minor wording changes for consistency with the Act.
- Section 3 Accounting policies for external financial reporting by the Government of New Zealand: Minor wording changes for clarity and extra guidance provided.
- Section 4.3.2 Revenue and expense offsetting: Renumbered section and extra guidance provided.
- Section 4.4.3 Provision for return of operating surplus: Minor wording changes for consistency with the Act.
- Section 6.2.5 Provision of other information: Minor wording changes for consistency with the Act.
- Section 6.3.1 Managing departmental expenditure: Minor wording changes for consistency with Cabinet Office circulars CO (09) 06 and CO (99) 6.
- Section 6.3.3 Foreign exchange exposure management: Minor wording changes for better readability.
- Section 6.3.5 Prohibition on investing, borrowing or lending: Minor wording changes for accuracy and consistency.
- Section 6.3.5.1 Obtaining authority to enter into finance leases: Minor wording changes for accuracy and consistency.

- Section 6.4.2 Authority to operate Crown bank accounts: Correction of section reference to the Act.
- Section 6.4.4 Disbursement of Crown expenditure: Extra guidance provided.
- Section 6.4.8 Public Private Partnerships: New section added.
- Section 6.5.2 Bank accounts: Correction of section reference to the Act.
- Section 6.5.3 Departmental bank accounts: Clarification that departments have permission to enter into discounting facilities.
- Section 6.6.2 Trust money notice of appointment: Minor wording change for clarity.
- Section 6.7.5 Power to give guarantees: Minor wording change for consistency with the Act.

1.8 Relationship between Treasury Instructions and Treasury Circulars

Treasury Instructions

Treasury Instructions are issued under section 80(1) of the Act. Treasury may issue instructions to departments for the purpose of:

- requiring information to be supplied to Treasury to enable the Treasury to fulfil properly the functions imposed upon it by the Government or any Act;
- prescribing the processes and data standards to be used when supplying the information required;
- prescribing particular accounting policies and financial statement representations that Ministers, departments, Offices of Parliament, Crown entities or organisations named or described in Schedule 4 to the Act must apply in their financial reporting;
- prescribing the terms and conditions that must apply to the guarantees or indemnities referred to under section 81(1)(bb) of the Act;
- prescribing any other matters relating to the guarantees or indemnities referred to under section 81(1)(bb) of the Act;
- regulating the collection, receipt, custody, issue, expenditure, control and management of public money or trust money;
- regulating the accounting and financial management and control procedures relating to contracts of the Crown; and
- regulating the custody and control by the Crown of public securities and securities representing the investment of public money; and providing for the appointment of custodians of such securities and prescribing their functions, duties and powers.

Treasury Instructions generally specify what the Chief Executive Crown must do. Treasury Instructions are signed on behalf of the Secretary to the Treasury and all Chief Executives are required to comply with them to the extent that they apply to the relevant department.

The main purpose of Treasury Circulars is to provide guidance and information, and to request financial information. Treasury Circulars may cover matters that are outside the scope of Treasury Instructions, such as the budget timetable. Since Treasury Instructions are updated annually, Treasury Circulars may also cover matters that are to take effect immediately (but may later be incorporated within Treasury Instructions as part of an annual update).

Treasury Circulars are intended principally for departmental (and sometimes Crown Entities and State-owned enterprises) use and they are usually addressed to Chief Executives/Chief Financial Officers (CEs/CFOs).

For a list of current, publicly-available Treasury Circulars, please click here.

2 Principles for the development of accounting policies for external financial reporting

2.1 Introduction

This section provides guidance on the way in which the Crown and its departments must set their accounting policies for external financial reporting. Accounting policies are those broad concepts, rules and procedures that underlie the preparation and presentation of the financial statements of all entities.

When developing their accounting policies for external financial reporting, the Crown and its departments must comply with the requirements of the Act.

2.2 Legislative requirements

The Act requires that both forecast and annual financial statements of the Government and its departments must be prepared in accordance with generally accepted accounting practice (sections 26H, 27, 41 and 45B).

2.3 New Zealand generally accepted accounting practice

New Zealand generally accepted accounting practice for the financial statements of the Government and its departments is defined by section 2 of the Act. It is defined in the first instance as approved financial reporting standards as far as such standards apply to the Crown. An approved financial reporting standard is one that has been approved by the Accounting Standards Review Board (ASRB).

The ASRB approves:

(a) New Zealand equivalents to International Financial Reporting Standards (NZ IFRSs) comprising New Zealand equivalents to:

(i) International Financial Reporting Standards;

(ii) International Accounting Standards; and

(iii) International Interpretations (IFRICs and SICs); and

(b) Financial Reporting Standards (FRSs).

Consequently, where there is an approved New Zealand financial reporting standard that prescribes the accounting treatment for a particular accounting issue, the Crown's and departments' accounting policies for external financial reporting in relation to that particular accounting issue must comply with that financial reporting standard, unless that standard does not apply to the Crown or its departments.

In the absence of an applicable approved New Zealand financial reporting standard, and the absence of an applicable rule of law, the Act provides that generally accepted accounting practice means accounting policies that are appropriate in relation to the Crown and have authoritative support within the accounting profession in New Zealand.

NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (NZ IAS 8) (paragraphs 10 to 12) provides guidance on developing accounting policies in the absence of a particular standard or an interpretation of a standard that specifically applies to a transaction, other event or condition. NZ IAS 8 requires that management use judgement in developing and applying an accounting policy that results in information that is relevant to the economic decision-making needs of users and reliable; it specifies what reliability means in the context of the financial statements. It also requires that management refer to and consider the applicability of the following sources of guidance, in descending order:

(a) the requirements and guidance in standards, and interpretations dealing with similar and related issues; and

(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the New Zealand Equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements* (NZ *Framework)*.

In making this judgement management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature, and accepted industry practices, to the extent these do not conflict with the sources described above.

The NZ *Preface* to NZ IFRSs (paragraph 38) explains that it is a matter of professional judgement in the circumstances of the entity as to which other sources of authoritative support should be considered, and how conflicts between other sources of authoritative support should be resolved in determining generally accepted accounting practice.

The NZ *Preface* (paragraph 39) gives examples of sources of authoritative support. Technical Practice Aids issued by the FRSB are an example of pronouncements of a recognised standard setting body and therefore are a source of guidance that may be used in developing and applying accounting policies. Other examples of pronouncements of standard-setting bodies include:

(a) International Public Sector Accounting Standards (IPSASs) issued by the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC);

(b) financial reporting standards issued by the Australian Accounting Standards Board (AASB); and

(c) financial reporting standards issued by well-recognised bodies with the authority to promulgate financial reporting standards in jurisdictions such as Canada, the United Kingdom and the United States of America.

When developing accounting policies for accounting issues that are not covered by an applicable approved New Zealand financial reporting standard, the Crown and departments must exercise appropriate professional judgment in applying the requirements of NZ IAS 8, in determining the relative importance of sources of authoritative support and in resolving conflicts between different sources of authoritative support.

In such circumstances the Crown and its departments must ensure that the policy that is developed is consistent with the New Zealand Equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements*. Any such policy must:

- **meet the objectives of general purpose financial reporting;**
- **be prepared with due regard to the assumptions that underlie general purpose financial reports;**
- **have the required qualitative characteristics of general purpose (external) financial reports; and**
- **adhere to the definitions of, and recognition criteria for, all financial elements.**

New Zealand generally accepted accounting practice includes NZ IFRSs and any domestic Financial Reporting Standards that have been approved as financial reporting standards by the ASRB. These standards apply after an entity makes an explicit statement of compliance with NZ IFRSs for the first time. The Crown has applied NZ IFRSs in the forecast financial statements published in the 2007 budget, and will apply them in financial statements prepared for periods beginning on or after 1 July 2007.

2.3.1 Asserting compliance with NZ GAAP

The financial statements of the Government and of each department must include an assertion of compliance with NZ GAAP. NZ IAS 1 paragraph NZ 15.1 requires that an entity shall disclose in the notes:

(a) the statutory base, if any, under which the financial statements are prepared;

(b) whether, for the purposes of complying with Generally Accepted Accounting Practice in New Zealand (NZ GAAP), it is a profit-oriented or public benefit entity;

(c) if, for the purposes of complying with NZ GAAP, it is a qualifying entity and has applied differential reporting concessions. In accordance with NZ IAS 8, such an entity shall disclose the criteria which establish the entity as a qualifying entity for differential reporting and the extent to which the entity has applied available differential reporting concessions; and

(d) a statement that the financial statements have been prepared in accordance with NZ GAAP, together with a description of the financial reporting standards applied by the entity.

Departmental financial statements must therefore include:

(a) a reference to the Public Finance Act 1989 and any other legislation establishing financial reporting requirements;

(b) a statement that for the purposes of complying with NZ GAAP it is a public benefit entity. All departments will be public benefit entities, although some components of departments may be profit-oriented; and

(c) a statement that the financial statements have been prepared in accordance with NZ GAAP and that they comply with NZ IFRSs, and other applicable Financial Reporting Standards, as appropriate for public benefit entities.

2.3.2 Objectives of general purpose financial reporting

The NZ *Framework* (paragraphs 12 to NZ 14.2) discusses the objectives of general purpose financial statements and non-financial statements or supplementary information that accompanies financial statements. These objectives include:

- providing information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions;
- showing the results of the stewardship of management, or the accountability of management for the resources entrusted to it; and
- assessing the reporting entity's compliance with legislation, regulations, common law and contractual arrangements.

2.3.3 Assumptions underlying general purpose financial reports

Two assumptions underlie the development of general purpose financial reports:

- the "going concern" concept; and
- the accrual basis of accounting.

2.3.3.1 The accrual basis of accounting

Under the accrual basis of accounting, the effects of transactions and other events must be recognised when they occur (and not as cash or its equivalent is received or paid). The transactions must be recorded in the accounting records, and reported in the financial statements of the periods to which they relate. Financial statements prepared on the accrual basis inform users not only of past transactions involving the payment and receipt of cash, but also of obligations to pay cash in the future and of resources that represent cash to be received in the future. **The Chief Executive of a department of the Crown must ensure that the financial statements of the department are prepared each year using the accrual basis of accounting.**

2.3.3.2 The "going concern" concept

The “going concern” concept is the accounting convention under which the financial statements are prepared on the assumption that the entity is a going concern and will continue in operation for the foreseeable future. As a consequence, items of property, plant and equipment must be depreciated over their anticipated useful lives, inventory is assumed to be realisable within the normal operating cycle, and liabilities are assumed not to fall due before their scheduled repayment date. **Unless the Chief Executive of a department of the Crown receives clear evidence to the contrary, he or she must assume, for the purposes of preparing the financial statements in each year, that the Crown does not intend, nor is there a need for, a department to cease operations or to curtail them materially.**

The concept that the entity will continue as a going concern underlies the preparation of the financial statements. If the assumption of the “going concern” concept is no longer true, the financial statements may have to be prepared on a different basis (with that basis being disclosed) (NZ *Framework* paragraph 23).

NZ IAS 1 specifies required disclosures if:

(a) the financial statements are not prepared on a going concern basis; or

(b) management is aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.

If the events or conditions requiring disclosure arise after the balance sheet date, NZ IAS 10 *Events after the Balance Sheet Date* should be used in determining the appropriate disclosures. If the going concern assumption is no longer appropriate NZ IAS 10 requires a fundamental change in the basis of accounting. However, it also notes that judgement is required in determining the impact of a change in the basis of accounting.

2.3.4 Qualitative characteristics of external financial reports

The NZ *Framework* states in paragraph 24 that qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The four principal qualitative characteristics are understandability, relevance, reliability and comparability.

2.3.4.1 Understandability

An essential quality of the information provided in financial statements is that it is readily understandable by users. For this purpose, users are assumed to have a reasonable knowledge of an entity's activities and accounting and a willingness to study the information with reasonable diligence. However, information about complex matters should not be excluded merely on the grounds that it may be too difficult for certain users to understand.

2.3.4.2 Relevance

Information is considered to be relevant to users, if it can be used to confirm or correct prior assumptions or beliefs about past events, or if it can be used to assist in forming or revising expectations about future events. Timeliness is considered to be an important element of relevance, as information that is not available when it is needed is of no use.

2.3.4.3 Reliability

Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent (NZ *Framework* paragraph 31). Information may be relevant but so unreliable in nature or representation that its recognition may be potentially misleading (NZ *Framework* paragraph 32).

2.3.4.4 Comparability

Information is comparable when users are able to identify similarities and differences between that information and the information in other reports of the entity for different periods, or the reports of other entities. Compliance with NZ GAAP, including the disclosure of the accounting policies used by the entity, helps to achieve comparability.

2.3.5 Materiality

External financial reports must be prepared having due regard to the materiality of the information being provided. In particular, the inclusion of transactions, the level of disclosure and the effect of an accounting treatment should be considered in the light of an appropriate materiality level.

The relevance of information is affected by its nature and materiality. Guidance on the concept of materiality is contained in the NZ *Framework* and NZ IAS 1.

The NZ *Framework* states that information is material if:

- its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements (paragraph 30); and/or
- in the case of public benefit entities, its non-disclosure could influence the decision-making and evaluations of users about the allocation and stewardship of resources, and the performance of the entity, made on the basis of the financial statements (paragraph NZ 30.1).

Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement.

A number of groups rely upon the financial statements of departments for accountability and for decision making. These groups include:

- Parliamentarians;
- Ministers;
- Treasury; and
- Media and the public.

Materiality must be considered in the light of the accountability requirements of, and decisions made by, these groups.

Where a specific disclosure is required as a result of a statutory obligation, regulation, or Treasury Instruction, that disclosure must be made regardless of the materiality of the item.

2.3.6 Financial elements

The NZ *Framework* defines five elements of financial statements and provides recognition criteria for each of them. The five elements are assets, liabilities, equity, income and expenses.

The NZ *Framework* uses the term “future economic benefits”. In the case of public benefit entities, this term is to be read as having the same meaning as the term “service potential” (NZ *Framework* paragraph NZ 49.1).

The NZ *Framework* also refers to contributions from, or distributions to, equity participants. In the context of public benefit entities such references should be read as contributions from, or distributions to, equity holders acting in their capacity as equity holders (NZ *Framework* paragraph NZ 70.1).

An item that meets the definition of an element should be recognised if:

(a) it is probable that any future economic benefit (or service potential) associated with the item will flow to or from the entity; and

(b) the item has a cost or value that can be measured with reliability (NZ *Framework* paragraph 83).

2.3.6.1 Assets

An asset is a resource controlled by the entity as a result of past events and from which future economic benefits (or service potential) are expected to flow to the entity.

2.3.6.2 Liabilities

A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits (or service potential).

2.3.6.3 Equity (Taxpayers' funds)

Equity is the residual interest in the assets of the entity after deducting all its liabilities.

2.3.6.4 Income

Income is increases in economic benefits (or service potential) during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants (equity holders acting in their capacity as equity holders).

The definition of income includes both revenue from ordinary activities and gains.

The definition of revenue is very similar to the definition of income but it refers to inflows "arising in the course of the ordinary activities of an entity" (NZ IAS 18 *Revenue* paragraph 7).

Gains represent other items that meet the definition of income, and may or may not arise in the course of the entity's ordinary activities (NZ *Framework* paragraph 75).

2.3.6.5 Expenses

Expenses are decreases in economic benefits (or service potential) during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants (equity holders acting in their capacity as equity holders).

The definition of expenses include expenses from ordinary activities and losses.

2.4 Accounting policies

The notes to general purpose financial statements must include a summary of significant accounting policies (NZ IAS 1 paragraph 117). This summary must include:

- the measurement basis (or bases) used in preparing the financial statements; and
- the other accounting policies used that are relevant to an understanding of the financial statements.

NZ IAS 8 specifies the disclosures required as a result of changes in accounting policies.

An entity must also disclose the judgements, apart from those involving estimations, management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements (NZ IAS 1 paragraph 125).

3 Accounting policies for external financial reporting by the Government

3.1 Introduction

This section of the Treasury Instructions details the accounting policies for inclusion in the external financial statements of the Government for the year ended 30 June 2010 and 30 June 2011.

3.2 Reporting entity

The consolidated financial statements for the Government reporting entity as defined in the Act must be prepared in accordance with the requirements of the Act.

Government reporting entity, as defined in section 2(1) of the Act, means:

- the Sovereign in right of New Zealand; and
- the legislative, executive, and judicial branches of the Government of New Zealand.

The description “Consolidated financial statements for the Government reporting entity” and the description “Financial statements of the Government” have the same meaning and can be used interchangeably.

3.2.1 Public benefit entity

For the purposes of financial reporting the Government of New Zealand is a public benefit entity.

3.3 General accounting policies

The Financial Statements of the Government of New Zealand must comply with generally accepted accounting practice.

The measurement base to be applied is historic cost modified by the revaluation of certain assets and liabilities.

Financial statements are to be prepared on an accrual basis.

The financial statements are to be presented in New Zealand dollars rounded to the nearest million, unless separately identified.

3.4 Judgments and estimations

The preparation of these financial statements requires judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. For example, the present value of large cash flows that are predicted to occur a long time into the future, as with the settlement of ACC outstanding claims obligations and Government Superannuation retirement benefits, depends critically on judgments regarding the time value of money, the risk free rate and inflation assumptions. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

Where material, information on the major assumptions used in preparing the financial statements must be provided in the relevant accounting policy or the relevant note.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised, if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgments that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year must be discussed in the notes.

3.5 Specific accounting policies

3.5.1 Reporting and forecast period

The reporting and forecast period for the financial statements of the Government of New Zealand is the financial year from 1 July to 30 June.

Where necessary the financial information for State-owned enterprises and Crown entities that have a balance date other than 30 June will be adjusted for any transactions or events that have occurred since their most recent balance date and that are significant for the Government's financial statements. Such entities are primarily in the education sector.

3.5.2 Basis of combination

Ministers of the Crown, Government departments, Offices of Parliament, the Reserve Bank of New Zealand, the New Zealand Superannuation Fund, State-owned enterprises (including Air New Zealand Limited), Crown entities (excluding Tertiary education institutions) and organisations listed in Schedule 4 to the Act are combined using the acquisition method of combination.

Corresponding assets, liabilities, income and expenses, are added together line by line. Transactions and balances between these sub-entities are eliminated on combination. Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies into line with those used by the Government reporting entity.

Where a subsidiary has a balance date other than 30 June, and their information is not reported to 30 June, the information reported to their most recent balance date is adjusted for any transactions that have occurred since then that are significant for the Government's financial statements.

Tertiary education institutions are equity accounted, which recognises these entities' net assets, including asset revaluation movements and surpluses and deficits.

The basis of combination for joint ventures depends on the form of the joint venture.

- Jointly-controlled operations: The Government reporting entity recognises the assets it controls, the liabilities and expenses that it incurs, and its share of the jointly-controlled operations' income.
- Jointly-controlled assets: The Government reporting entity recognises its share of the jointly-controlled assets, its share of any liabilities and expenses incurred jointly, any other liabilities

and expenses it has incurred in respect of the jointly-controlled asset, and income from the sale or use of its share of the output of the jointly-controlled asset.

- Jointly-controlled entities: Jointly-controlled entities are equity accounted, whereby the Government reporting entity initially recognises its share of interest in these entities' net assets at cost and subsequently adjusts the cost for changes in net assets. The Government reporting entity's share of the jointly-controlled entity's surpluses and deficits is recognised in the Statement of Financial Performance.

3.5.3 Income

3.5.3.1 Taxation revenue levied through the Crown's sovereign power

The Government provides many services and benefits that do not give rise to revenue. Further, payment of tax does not of itself entitle a taxpayer to an equivalent value of services or benefits, since there is no relationship between paying tax and receiving Crown services and transfers. Such revenue is received through the exercise of the sovereign power of the Crown in Parliament.

Where possible, taxation revenue must be recognised at the time the debt to the Crown arises.

Revenue type	Revenue recognition point
Source deductions	When an individual earns income that is subject to PAYE
Resident withholding tax	When an individual is paid interest or dividends subject to deduction at source
Fringe benefit tax (FBT)	When benefits are provided that give rise to FBT
Provisional tax	When taxable income is earned
Terminal tax	Assessment filed date
Goods and services tax (GST)	When the liability to the Crown is incurred
Customs and excise duty	When goods become subject to duty
Road user charges and motor vehicle fees	When payment of the fee or charge is made
Stamp, cheque and credit card duties	When the liability to the Crown is incurred
Exhaustible resources levy	When the resource is extracted
Other indirect taxes	When the debt to the Crown arises
Levies (e.g. ACC levies)	When the obligation to pay the levy is incurred

3.5.3.2 Revenue earned through operations

Revenue from operations includes revenue that has been earned by the Crown in exchange for the provision of outputs (products or services) to third parties.

Revenue from the supply of goods and services to third parties must be measured at the fair value of consideration received. Revenue from the supply of goods must be recognised when the significant risks and rewards of ownership have been transferred to the buyer. Revenue from the supply of services must be recognised at balance date on a straight line basis over the specified period for the services unless an alternative method better represents the stage of completion of the transaction.

3.5.3.3 Interest income

Interest income must be accrued using the effective interest rate method.

The effective interest rate exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount. The method applies this rate to the principal outstanding to determine interest income each period.

3.5.3.4 Dividend income

Dividend income from investments must be recognised when the Government's rights as a shareholder to receive payment have been established.

3.5.3.5 Rental income

Rental income must be recognised in the Statement of Financial Performance on a straight-line basis over the term of the lease. Lease incentives granted must be recognised evenly over the term of the lease as a reduction in total rental income.

3.5.3.6 Donated or Subsidised Assets

Where a physical asset is acquired for nil or nominal consideration, the fair value of the asset received must be recognised as income in the Statement of Financial Performance.

3.5.4 Expenses

3.5.4.1 General

Expenses must be recognised in the period to which they relate.

3.5.4.2 Welfare benefits and entitlements

Welfare benefits and entitlements, including New Zealand Superannuation, must be recognised in the period when an application for a benefit has been received and the eligibility criteria met.

3.5.4.3 Grants and subsidies

Where grants and subsidies are discretionary until payment, the expense must be recognised when the payment is made. Otherwise, the expense must be recognised when the specified criteria have been fulfilled and notice has been given to the Crown.

3.5.4.4 Interest expense

Interest expense must be accrued using the effective interest rate method.

The effective interest rate exactly discounts estimated future cash payments through the expected life of the financial liability to that liability's net carrying amount. The method applies this rate to the principal outstanding to determine interest expense each period.

3.5.5 Foreign-currency

Transactions in foreign currencies must be initially translated at the foreign exchange rate at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies must be recognised in the Statement of Financial Performance, except when recognised in the Statement of Comprehensive Income when hedge accounting is applied.

Non-monetary assets and liabilities measured at historical cost in a foreign currency must be translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies and measured at fair value must be translated into New Zealand dollars at the exchange rate applicable at the fair value date. The associated foreign exchange gains or losses follow the fair value gains or losses to either the Statement of Financial Performance or the Statement of Comprehensive Income.

The exchange rate to be used in the translation of assets and liabilities denominated in foreign currencies is provided each month on the CFISnet home page.

Foreign exchange gains and losses arising from translating monetary items that form part of the net investment in a foreign operation must be reported in a translation reserve in net worth.

3.5.6 Sovereign receivables and taxes repayable

Receivables from taxes, levies and fines (and any penalties associated with these activities), as well as social benefit receivables which do not arise out of a contract are collectively referred to as sovereign receivables.

Sovereign receivables are initially assessed at nominal amount or face value; that is, the receivable reflects the amount of tax owed, levy, fine charged, or social benefit debt payable. These receivables are subsequently adjusted for penalties and interest as they are charged, and tested for impairment. Interest and penalties charged on tax receivables are presented as tax revenue in the statement of financial performance.

Taxes repayable represent refunds due to taxpayers and are recognised at their nominal value. They are subsequently adjusted for interest once account and refund reviews are complete.

3.5.7 Financial Instruments

Financial assets and financial liabilities must be designated into the categories in NZ IAS 39 *Financial Instruments: Recognition and Measurement* with reference to the business purpose of the financial instruments, policies and practices for their management, their relationship with other instruments and the reporting costs and benefits associated with each designation.

Financial assets and liabilities must be recognised and measured in accordance with NZ IAS 39.

3.5.7.1 Financial assets

Financial assets held for trading and financial assets designated at fair value through profit or loss must be recorded at fair value with any realised and unrealised gains or losses recognised in the Statement of Financial Performance.

The maximum loss due to default on any financial asset is the carrying value reported in the statement of financial position.

Major financial asset type	Designation
Trade and other receivables	All designated as loans and receivables
Student loans	All designated as loans and receivables
Kiwibank mortgages	Generally designated as loans and receivables
Other advances	Generally designated as loans and receivables
IMF financial assets	All designated as loans and receivables
Share investments	Generally designated as fair value through profit and loss
Marketable securities	Generally designated as fair value through profit and loss

Loans and receivables are recognised initially at fair value plus transaction costs and subsequently measured at amortised cost using the effective interest rate method (refer interest income policy). Loans and receivables issued with a duration of less than 12 months are recognised at their nominal value, unless the effect of discounting is material. Allowances for estimated irrecoverable amounts are recognised when there is objective evidence that the asset is impaired. Interest, impairment losses and foreign exchange gains and losses are recognised in the Statement of Financial Performance.

Financial assets held-for-trading and financial assets designated at fair value through profit or loss are recorded at fair value with any realised and unrealised gains or losses recognised in the Statement of Financial Performance.

A financial asset is designated at fair value through profit and loss if acquired principally for the purpose of trading in the short term. It may also be designated into this category if the accounting treatment results in more relevant information because it either significantly reduces an accounting mismatch with related liabilities or is part of a group of financial assets that is managed and evaluated on a fair value basis, such as with the NZ Superannuation Fund. Gains or losses from interest, foreign exchange and other fair value movements are separately reported in the Statement of Financial Performance. Transaction costs are expensed as they are incurred.

Available-for-sale financial assets are initially recorded at fair value plus transaction costs. They are subsequently recorded at fair value with any resultant fair value gains or losses recognised in the Statement of Comprehensive Income except for impairment losses, any interest calculated using the effective interest method and, in the case of monetary items (such as debt securities), foreign exchange gains and losses resulting from translation differences due to changes in amortised cost of the asset. These latter items are recognised in the statement of financial performance. For non-monetary available-for-sale financial assets (e.g. some unlisted equity instruments) the fair value movements recognised in the Statement of Comprehensive Income include any related foreign exchange component. At derecognition, the cumulative fair value gain or loss previously recognised directly in the Statement of Comprehensive Income is recognised in the Statement of Financial Performance.

Cash and cash equivalents include cash on hand, cash in transit, bank accounts and deposits with an original maturity of no more than three months.

Fair values of quoted investments are based on current bid prices. Regular way purchases and sales of all financial assets are accounted for at trade date. If the market for a financial asset is not active, fair values for initial recognition and, where appropriate, subsequent measurement are established by using valuation techniques. At each balance date an assessment is made whether there is objective evidence that a financial asset or group of financial assets is impaired.

3.5.7.2 Financial liabilities

Major financial liability type	**Designation**
Accounts payable	All designated at amortised cost
Government stock	Generally designated at amortised cost
Government retail stock	Generally designated at amortised cost
Treasury bills	Generally designated as fair value through profit and loss
Settlement deposits with Reserve Bank	Generally designated as fair value through profit and loss
Issued currency	Not designated: recognised at face value

Financial liabilities held for trading and financial liabilities designated at fair value through profit or loss must be recorded at fair value with any realised and unrealised gains or losses recognised in the Statement of Financial Performance. A financial liability is designated at fair value through profit and loss if acquired principally for the purpose of selling in the short term. It may also be designated into this category if the accounting treatment results in more relevant information because it either eliminates or significantly reduces an accounting mismatch with related assets or is part of a group of financial liabilities that is managed and evaluated on a fair value basis. Gains or losses from interest, foreign exchange and other fair value movements are separately reported in the Statement of Financial Performance. Transaction costs are expensed as they are incurred.

Other financial liabilities must be recognised initially at fair value less transaction costs and subsequently measured at amortised cost using the effective interest rate method. Financial liabilities entered into with a duration of less than 12 months are recognised at their nominal value. Amortisation and, in the case of monetary items, foreign exchange gains and losses, are recognised in the Statement of Financial Performance as is any gain or loss when the liability is derecognised.

Currency issued for circulation, including demonetised currency after 1 July 2004, is recognised at face value. Currency issued represents a liability in favour of the holder.

3.5.7.3 Derivatives

Derivative financial instruments must be recognised both initially and subsequently at fair value. They are reported as either assets or liabilities depending on whether the derivative is in a net gain or net loss position respectively. Recognition of the movements in the value of derivatives depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged (see Hedging section below).

Derivatives that are not designated as for hedge accounting are classified as held-for-trading financial instruments with fair value gains or losses recognised in the Statement of Financial Performance. Such derivatives may be entered into for risk management purposes, although not formally designated for hedge accounting, or for tactical trading.

3.5.7.4 Hedging

Individual entities consolidated within the Government reporting entity apply hedge accounting after considering the costs and benefits of adopting hedge accounting, including whether an economic hedge exists and the effectiveness of that hedge, whether the hedge accounting qualifications could be met, and the extent it would improve the relevance of reported results.

Transactions between entities within the Government reporting entity do not qualify for hedge accounting in the financial statements of the Government (although they may qualify for hedge accounting in the separate financial statements of the individual entities). Where a derivative is used to hedge the foreign exchange exposure of a monetary asset or liability, the effects of the hedge relationship are automatically reflected in the Statement of Financial Performance so hedge accounting is not necessary.

(a) Cash flow hedge

Where a derivative qualifies as a hedge of variability in asset or liability cash flows (cash flow hedge), the effective part of any gain or loss on the derivative may be recognised in the Statement of Comprehensive Income and the ineffective part must be recognised in the Statement of Financial Performance. Where the hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability (e.g. where the hedge relates to purchase of an asset in a foreign currency), the amount recognised in the Statement of Comprehensive Income is included in the initial cost of the asset or liability. Otherwise, gains or losses recognised in the Statement of Comprehensive Income transfer to the Statement of Financial Performance in the same periods as when the hedged item affects the Statement of Financial Performance (e.g. when the forecast sale occurs). Effective parts of the hedge are recognised in the same area of the Statement of Financial Performance as the hedged item.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in net worth at that time remains in net worth and is recognised when the forecast transaction is ultimately recognised in the Statement of Financial Performance. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in the Statement of Comprehensive Income is transferred to the Statement of Financial Performance.

(b) Fair value hedge

Where a derivative qualifies as a hedge of the exposure to changes in fair value of an asset or liability (fair value hedge) any gain or loss on the derivative is recognised in the Statement of Financial Performance together with any changes in the fair value of the hedged asset or liability.

The carrying amount of the hedged item is adjusted by the fair value gain or loss on the hedged item in respect of the risk being hedged. Effective parts of the hedge are recognised in the same area of the Statement of Financial Performance as the hedged item.

3.5.8 Inventories

Inventories must be accounted for in accordance with the relevant financial reporting standard (refer NZ IAS 2 *Inventories* and NZ IAS 41 *Agriculture*).

Inventories are recorded at the lower of cost (calculated using weighted average method) and net realisable value. Inventories held for distribution for public benefit purposes are recorded at cost, adjusted where applicable for any loss of service potential. Where inventories are acquired at no cost, or for nominal consideration, the cost is deemed to be the current replacement cost at the date of acquisition.

Inventories include unissued currency and harvested agricultural produce (e.g. logs, wool).

The cost of harvested agricultural produce is measured at fair value less estimated point-of-sale costs at the point of harvest.

3.5.9 Property, plant and equipment

Items of property, plant and equipment are initially recorded at cost. Cost may include transfers from net worth of any gains/losses on qualifying cash flow hedges of foreign currency purchases of property, plant and equipment. Where an asset is acquired for nil or nominal consideration the asset is recognised initially at fair value, where fair value can be reliably determined, and as income in the Statement of Financial Performance.

Revaluations are carried out for a number of classes of property, plant and equipment to reflect the service potential or economic benefit obtained through control of the asset. Revaluation is based on the fair value of the asset, with changes reported by class of asset.

Subsequent to initial recognition, classes of property, plant and equipment must be accounted for as set out below.

Class of PPE	Accounting policy
Land & Buildings	**Land and buildings are recorded at fair value less impairment losses and, for buildings, less depreciation accumulated since the assets were last revalued.** **Valuations undertaken in accordance with standards issued by the New Zealand Property Institute are used where available.** **Otherwise, valuations conducted in accordance with the Rating Valuation Act 1998, may be used if they have been confirmed as appropriate by an independent valuer.** **When revaluing buildings, there must be componentisation to the level required to ensure adequate representation of the material components of the buildings. At a minimum, this requires componentisation to three levels: structure, building services and fit-out.**
Specialist Military Equipment	Specialist military equipment is recorded on a depreciated replacement cost basis less depreciation and impairment losses accumulated since the assets were last revalued. Valuations are obtained through specialist assessment by New Zealand Defence Force advisers, and the bases of these valuations are confirmed as appropriate by an independent valuer.
State Highways	State highways are recorded on a depreciated replacement cost basis less depreciation and impairment losses accumulated since the assets were last revalued. Land associated with the state highways is valued using an opportunity cost based on adjacent use, as an approximation to fair value.
Rail Network	The Rail Network is recorded on a depreciated replacement cost basis less depreciation and impairment losses accumulated since the assets were last revalued. Land associated with the rail network is valued using an opportunity cost based on adjacent use, as an approximation to fair value.
Aircraft	Aircraft (excluding specialised military equipment) are recorded at fair value less depreciation and impairment losses accumulated since the assets were last revalued.
Electricity Distribution	Electricity distribution network assets are recorded at cost, less depreciation and impairment losses accumulated since the assets were purchased.
Electricity Generation	Electricity generation assets are recorded at fair value less depreciation and impairment losses accumulated since the assets were last revalued.
Other Plant and Equipment	Other plant and equipment, which include motor vehicles and office equipment, are recorded at cost less depreciation and impairment losses accumulated since the assets were purchased.

Class of PPE	Accounting policy
Specified cultural and heritage assets	Specified cultural and heritage assets comprise national parks, conservation areas and related recreational facilities, as well as National Archives holdings and the collections of the National Library, Parliamentary Library and Te Papa. Such physical assets are recorded at fair value less subsequent impairment losses and, for non-land assets, less subsequent accumulated depreciation. Assets are not reported with a financial value in cases where they are not realistically able to be reproduced or replaced, when they do not generate cash flows and where no market exists to provide a valuation.

Classes of property, plant and equipment that are revalued, must be revalued at least every five years or whenever the carrying amount differs materially to fair value.

Items of property must be revalued to fair value for the highest and best use of the item on the basis of the market value of the item, or on the basis of market-based evidence, such as discounted cash flow calculations. If no market-based evidence of fair value exists, an optimised depreciated replacement cost approach is used as the best proxy for fair value. Where an item of property is recorded at its optimised depreciated replacement cost, the cost must be based on the estimated present cost of constructing the existing item of property by the most appropriate method of construction, less allowances for physical deterioration and optimisation for obsolescence and relevant surplus capacity. Where an item of property is recorded at its optimised depreciated replacement cost, the cost does not include any borrowing costs.

Unrealised gains and losses arising from changes in the value of property, plant and equipment are recognised as at balance date. To the extent that a gain reverses a loss previously charged to the Statement of Financial Performance for the asset class, the gain is credited to the Statement of Financial Performance. Otherwise, gains are credited to an asset revaluation reserve for that class of asset. To the extent that there is a balance in the asset revaluation reserve for the asset class any loss is debited to the reserve. Otherwise, losses are reported in the Statement of Financial Performance.

Realised gains and losses arising from disposal of property, plant and equipment are recognised in the Statement of Financial Performance in the period in which the transaction occurs. Any balance attributable to the disposed asset in the asset revaluation reserve is transferred to taxpayer funds.

Generally, government borrowings are not directly attributable to individual assets. Therefore, any borrowing costs incurred during the period required to complete and prepare the asset for its intended use are expensed rather than capitalised.

The carrying amounts of plant, property and equipment must be reviewed at least annually to determine if there is any indication of impairment. Where an asset's recoverable amount is less than its carrying amount, it will be reported at its recoverable amount and an impairment loss will be recognised. The main reason for holding some assets (for example, electricity generation assets) is to generate cash. For these assets the recoverable amount is the higher of the amount that could be recovered by sale (after deducting the costs of sale) or the amount that will be generated by using the asset through its useful life. Some assets do not generate cash (for example, state highways) and for those assets, depreciated replacement cost is used. Losses resulting from impairment are reported in the Statement of Financial Performance, unless the asset is carried at a revalued amount in which case any impairment loss is treated as a revaluation decrease.

Depreciation must be charged on a straight-line basis at rates calculated to allocate the cost or valuation of an item of property, plant and equipment, less any estimated residual value, over its remaining useful life.

Typically, the estimated useful lives of different classes of property, plant and equipment are as follows:

Class of PPE	Estimated useful lives
Buildings	25 to 60 years
Specialist military equipment	5 to 55 years
State highways: Pavement (surfacing) Pavement (other) Bridges	 7 years 50 years 70 to 105 years
Rail Network: Track and ballast Tunnels and bridges Overhead traction and signalling	 25 to 40 years 60 to 100 years 10 to 40 years
Aircraft (excluding specialist military equipment)	10 to 20 years
Electricity distribution network	2 to 80 years
Electricity generation assets	25 to 55 years
Other plant and equipment	3 to 30 years

Specified heritage and cultural assets are generally not depreciated.

3.5.10 Equity accounted investments

The applicable financial reporting standards that determine the basis of combination of entities that make up the Government reporting entity are NZ IAS 27: *Consolidated and Separate Financial Statements* and NZ IAS 28: *Investments in Associates.* NZ IAS 27 refers to guidance provided in IPSAS 6: *Consolidated and Separate Financial Statements* and FRS 37: *Consolidating Investments in Subsidiaries* which shall be used by public benefit entities in determining whether they control another entity.

These standards are, however, not clear about how the definitions of control and significant influence should be applied in some circumstances in the public sector, particularly where legislation provides public sector entities with statutory autonomy and independence, in particular with Tertiary Education Institutions. Treasury's view is that because the Government cannot determine its operating and financing policies, but does have a number of powers in relation to these entities, it is appropriate to treat them as associates.

3.5.11 Biological assets

Biological assets (e.g. trees and sheep) managed for harvesting into agricultural produce (e.g. logs and wool) or for transforming into additional biological assets must be measured at fair value less estimated point-of-sale costs, with any realised and unrealised gains or losses reported in the Statement of Financial Performance. Where fair value cannot be reliably determined, the asset is recorded at cost less accumulated depreciation and accumulated impairment losses. For commercial forests, fair value takes into account age, quality of timber and the forest management plan.

Biological assets not managed for harvesting into agricultural produce, or being transformed into additional biological assets are reported as property, plant and equipment in accordance with the policies for property, plant and equipment.

3.5.12 Intangible assets

Intangible assets must be initially recorded at cost. The cost of intangible assets acquired in a business combination is their fair values at date of acquisition. Where an intangible asset is acquired for nil or nominal consideration it is also initially carried at cost, which by definition is nil/nominal. The treatment outlined in NZ IAS 38 *Intangible Assets* (paragraph 44) exemption is for recipients of government grants and is not applicable for the financial statements of the Government. NZ IAS 38 also does not contemplate the situation of assets being internally generated through legislation or regulation. Entities with intangible assets generated through legislation or regulation should consult the Treasury.

The cost of an internally generated intangible asset represents expenditure incurred in the development phase of the asset only. The development phase occurs after the following can be demonstrated: technical feasibility; ability to complete the asset; intention and ability to sell or use; and development expenditure can be reliably measured. Research is “original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding”. Expenditure incurred on the research phase of an internally generated intangible asset is expensed when it is incurred. Where the research phase cannot be distinguished from the development phase, the expenditure is expensed when it is incurred.

The Government’s holdings of assigned amount units arising from the Kyoto protocol are reported at fair value. Other intangible assets with finite lives are subsequently recorded at cost less any amortisation and impairment losses. Amortisation is charged to the Statement of Financial Performance on a straight-line basis over the useful life of the asset. Typically, the estimated useful life of computer software is 3 to 5 years.

Assets with indefinite useful lives are not amortised, but are tested at least annually for impairment.

Realised gains and losses arising from disposal of intangible assets are recognised in the Statement of Financial Performance in the period in which the transaction occurs.

Intangible assets with finite lives must be reviewed at least annually to determine if there is any indication of impairment. An intangible asset with an indefinite life must be tested for impairment annually. Where an intangible asset’s recoverable amount is less than its carrying amount, it will be reported at its recoverable amount and an impairment loss will be recognised. Losses resulting from impairment are reported in the Statement of Financial Performance.

Goodwill is tested for impairment annually.

3.5.13 Non-current assets held for sale and discontinued operations

Non-current assets or disposal groups are separately classified where their carrying amount will be recovered through a sale transaction rather than continuing use; that is, where such assets are available for immediate sale and where sale is highly probable. **Non-current assets or disposal groups must be recorded at the lower of their carrying amount and fair value less costs to sell.**

3.5.14 Investment Property

Investment property is property held primarily to earn rentals or for capital appreciation or both. It does not include property held primarily for strategic purposes or to provide a social service (e.g. affordable housing) even though such property may earn rentals or appreciate in value – such property is reported as property, plant and equipment.

Investment properties must be measured at fair value. Gains or losses arising from fair value changes are included in the Statement of Financial Performance. Valuations are undertaken in accordance with standards issued by the New Zealand Property Institute.

The cost model is permitted only where the fair value cannot be reliably determined. Entities with investment property that cannot be reliably determined must provide Treasury with details of such investment properties.

3.5.15 Employee benefits

Employee benefits must be accounted for in accordance with NZ IAS 19 *Employee Benefits*.

3.5.15.1 Pension liabilities

Obligations for contributions to defined contribution retirement plans are recognised in the Statement of Financial Performance as they fall due. Obligations for defined benefit retirement plans are recorded at the latest actuarial value of the Crown liability. All movements in the liability, including actuarial gains and losses, are recognised in full in the Statement of Financial Performance in the period in which they occur.

3.5.15.2 Other employee entitlements

Employee entitlements to salaries and wages, annual leave, long service leave, retiring leave and other similar benefits are recognised in the Statement of Financial Performance when they accrue to employees. Employee entitlements to be settled within 12 months are reported at the amount expected to be paid. The liability for long-term employee entitlements is reported as the present value of the estimated future cash outflows.

In 2009 the Treasury issued two excel models (spreadsheets) to calculate long service leave and retiring leave liabilities that comply with NZ IAS 19. These models can be downloaded from Treasury Circular 2009/06. Entities that used the 1998 long service leave model, or have adapted another model based on Treasury Circular 1998/15, must switch to these new models for the financial year ending 30 June 2009 and beyond. However, an entity may continue to engage an independent actuary, or use their in-house valuation models approved by an independent actuary, rather than switch to the new in-house Treasury models.

3.5.15.3 Termination benefits

Termination benefits are recognised in the Statement of Financial Performance only when there is a demonstrable commitment to either terminate employment prior to normal retirement date or to provide such benefits as a result of an offer to encourage voluntary redundancy. Termination benefits settled within 12 months are reported at the amount expected to be paid, otherwise they are reported as the present value of the estimated future cash outflows.

3.5.16 Insurance contracts

The future cost of ACC claims liabilities must be revalued annually based on the latest actuarial information. Movements of the liability are reflected in the Statement of Financial Performance. Financial assets backing the liability are designated at fair value through profit and loss.

3.5.17 Leases

Finance leases and operating leases must be accounted for in accordance with NZ IAS 17 L*eases*.

Finance leases transfer, to the Crown as lessee, substantially all the risks and rewards incident on the ownership of a leased asset. Initial recognition of a finance lease results in an asset and liability being recognised at amounts equal to the lower of the fair value of the leased property or the present value of the minimum lease payments. The capitalised values are amortised over the period in which the Crown expects to receive benefits from their use.

Economically speaking, finance leases are a form of borrowing that, depending on an entity's borrowing powers, may require prior ministerial approval. See Treasury Instruction 6.3.5.1 which sets out issues to consider and information to provide when seeking approval for finance leases.

Operating leases, where the lessor substantially retains the risks and rewards of ownership, are recognised in a systematic manner over the term of the lease. Leasehold improvements are capitalised and the cost is amortised over the unexpired period of the lease or the estimated useful life of the improvements, whichever is shorter. Lease incentives received are recognised evenly over the term of the lease as a reduction in rental expense.

3.5.18 Other liabilities and provisions

Other liabilities and provisions must be recorded at the best estimate of the expenditure required to settle the obligation. Liabilities and provisions to be settled beyond 12 months are recorded at the present value of their estimated cash outflows.

3.5.19 Contingent assets and contingent liabilities

Contingent assets and contingent liabilities must be accounted for in accordance with NZ IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Contingent liabilities and contingent assets are recorded in the Statement of Contingent Liabilities and Contingent Assets at the point at which the contingency is evident. Contingent liabilities are disclosed if the possibility that they will crystallise is not remote. Contingent assets are disclosed if it is probable that the benefits will be realised.

3.5.20 Commitments

Commitments are future expenses and liabilities to be incurred on contracts that have been entered into at balance date.

Information on non-cancellable commitments must be disclosed in the Statement of Commitments.

Cancellable commitments that have penalty or exit costs explicit in the agreement on exercising the option to cancel must be included in the Statement of Commitments at the value of that penalty or exit cost (i.e. the minimum future payments).

Commitments must be classified as:

- Capital commitments: aggregate amount of capital expenditure contracted for but not recognised as paid or provided for at balance date. NZ IAS 16 *Property, Plant and Equipment* (paragraph 74(c)) requires the disclosure of contractual commitments for the acquisition of property, plant and equipment.
- Non-cancellable operating leases with a lease term of more than one year (as required by NZ IAS 17 *Leases*).
- Other non-cancellable commitments (these may include consulting contracts, cleaning contracts and ship charters).

Interest commitments on debts and commitments relating to employment contracts must not be included in the Statement of Commitments.

3.5.21 Comparatives

When presentation or classification of items in the financial statements is amended or accounting policies are changed voluntarily, comparative figures must be restated to ensure consistency with the current period unless it is impracticable to do so.

3.5.22 Segment analysis

The Government reporting entity is not required to provide segment reporting as it is a public benefit entity. Nevertheless, information is presented for material institutional components and major economic activities within or undertaken by the Government reporting entity. The three major institutional components of the Crown are:

- Core Crown: This group, which includes Ministers, government departments, offices of Parliament and the Reserve Bank of New Zealand, most closely represents the budget sector and provides information that is useful for fiscal analysis purposes.
- State-owned enterprises including entities governed by the State-Owned Enterprises Act 1986, and for the purposes of these Instructions also includes Air New Zealand, represents entities that undertake commercial activity.
- Crown entities: This group includes entities governed by the Crown Entities Act 2004. These entities have separate legal form and specified governance frameworks (including the degree to which each Crown entity is required to give effect to, or be independent of, government policy).

Functional analysis is also provided of a number of financial statements items. This functional analysis is drawn from the *Classification of the Functions of Government* produced by the *Organization for Economic Co-operation and Development*.

3.5.23 Related parties

The Government comprises a large number of commonly controlled entities. These entities, and their key management personnel, transact among themselves and with the Government reporting entity on a regular basis, for example, for the purchase of postage stamps or the registration of vehicles. The Act requires separate reporting by these individual entities and these entities will report transactions with the Crown and other related parties as appropriate in these individual financial statements.

With the exception of key management personnel, no other parties control the Government, are controlled by the Government without being consolidated, or are under the common control of another entity with the government. Tertiary education institutions, joint ventures and the Government Superannuation Fund are however considered related parties due to government influence and transactions between the rest of the Government reporting entity and these entities are separately disclosed where material.

4 Accounting and forecasting policy parameters for departmental external financial reporting

4.1 Explanatory note

To make the statements and forecasts of different departments comparable, and to ensure that the consolidated financial statements and forecasts of the Government reporting entity are prepared on a consistent basis, a department needs to report on a basis not materially different from the bases upon which other departments report. This is substantially achieved through all departments and the Government itself preparing their financial statements and forecasts within the same policy parameters.

The principles which must be used by departments when developing their accounting policies are outlined in Section 2 of the Treasury Instructions ("Principles for the development of accounting policies for external financial reporting").

This section of the Treasury Instructions focuses on the provision of information on the parameters within which departmental accounting policies must be developed, with particular reference, where appropriate, to:

- areas not yet specifically covered by generally accepted accounting practice;
- limiting choices in generally accepted accounting practice where this is necessary for consistency in the financial statements of the Government; and
- clarifying accounting treatments where generally accepted accounting practice and other legislative requirements may be in conflict.

4.2 Particular accounting policies: General

4.2.1 Statement of Responsibility

A department's financial report may be issued only when the Statement of Responsibility is signed by the department's Chief Executive and Chief Financial Officer.

4.2.2 Combination of sub-entities

Departments of the Crown must combine the results and financial position of all sub-entities. The sub-entities to be combined in a department's financial statements are those that fall within the definition provided by section 33 of the Act, which defines a department as including "any activities, bodies, or statutory offices that are funded by way of appropriation and that are not natural persons or separate legal entities".

For all sub-entities that are not joint ventures the purchase method, as described in NZ IFRS 3 *Business Combinations*, and the consolidation procedures outlined in NZ IAS 27 *Consolidated and Separate Financial Statements* must be used in preparing the department's financial statements. This method of preparing consolidated financial statements is sometimes referred to as a line-by-line consolidation.

Sub-entities that are joint ventures shall be accounted for in accordance with NZ IAS 31 *Interests in Joint Ventures* as follows.

- Jointly-controlled operations: The department shall recognise the assets it controls, the liabilities and expenses that it incurs, and its share of the jointly-controlled operations' income.

- Jointly-controlled assets: The department shall recognise its share of the jointly-controlled assets, its share of any liabilities and expenses incurred jointly, any other liabilities and expenses it has incurred in respect of the jointly-controlled asset, and income from the sale or use of its share of the output of the jointly-controlled asset.

- Jointly-controlled entities: The department shall recognise its share in a jointly-controlled entity using the equity method.

In the preparation of financial statements, all intra-departmental transfers and transactions must be eliminated. Accordingly, each sub-entity must identify and record transactions with other parts of the department. If it is not possible to eliminate absolutely all such transactions, all material intra-departmental transactions must be eliminated.

4.2.3 Goods and Services Tax

Goods and Services Tax (GST) is an indirect tax on goods and services.

GST is collected at various stages of production and distribution by registered persons in respect of their taxable activities.

The following financial statements and the equivalent forecast statements must be prepared on a net of GST basis (i.e. on a GST exclusive basis):

- **Statement of Financial Position (except for receivables and payables and any assets where GST input tax is irrecoverable);**

- **Statement of Financial Performance;**

- **Statement of Cash Flows;**

- **Statement of Service Performance;**

- **Statement of Commitments; and**

- **Statement of Contingent Liabilities.**

As appropriations are on a GST exclusive basis, the Statement of Unappropriated Expenditure must also be prepared exclusive of GST.

For non-departmental expenses and capital expenditure, the item shall be recorded net of GST where money is being paid:

- **on GST applicable products and services; and**

- **to a GST registered person.**

In other words, if the recipient of the payment is required to account for GST on the amount received, the expense shall be recorded net of GST.

Care must be taken when deducting input tax to ensure that it is not related to making GST-exempt supplies. Exempt supplies include financial services, residential rent, supplies of fine metal, interest charges and supplies of donated goods and services. If a purchase is connected with an exempt supply, any full amount should be recognised as part of the related asset or, where the expenditure relates to an expense item, expensed.

4.3 Particular accounting policies: Statement of Financial Performance items

4.3.1 Revenue recognition

Where revenue arises from the rendering of services, the sale of goods or the use of department's assets by others NZ IAS 18 must be applied. Most other revenue of departments will result from non-exchange transactions.

In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange. There are three factors relevant in determining whether departments render services in an exchange or receive revenue in a non-exchange transaction:

- whether the services are clearly specified;
- whether the value of the services is approximately equal to the funding; and
- whether the consideration that is provided is conditional on the services to be supplied.

The key requirements of NZ IAS 18 are:

- Revenue shall be measured at the fair value of the consideration received or receivable (NZ IAS 18 paragraph 9).
- Revenue from the sale of goods shall be recognised when all the following conditions have been satisfied:
  - the entity has transferred to the buyer the significant risks and rewards of ownership of the goods;
  - the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
  - the amount of revenue can be measured reliably;
  - it is probable that the economic benefits associated with the transaction will flow to the entity; and
  - the costs incurred or to be incurred in respect of the transaction can be measured reliably (NZ IAS 18 paragraph 14).
- When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction shall be recognised by reference to the

stage of completion of the transaction at the balance sheet date. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:

- the amount of revenue can be measured reliably;
- it is probable that the economic benefits associated with the transaction will flow to the entity;
- the stage of completion of the transaction at the balance sheet date can be measured reliably; and
- the costs incurred for the transaction and the costs to complete the transaction can be measured reliably (NZ IAS 18 paragraph 20).

- When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue shall be recognised only to the extent of the expenses recognised that are recoverable. (NZ IAS 18 paragraph 26).
- Interest revenue shall be recognised using the effective interest method as set out in NZ IAS 39, paragraphs 9 and AG5–AG8 (NZ IAS 18 paragraph 30).
- Revenue from royalties shall be recognised on an accrual basis in accordance with the substance of the relevant agreement (NZ IAS 18 paragraph 30).
- Revenue from dividends shall be recognised when the shareholder's right to receive payment is established (NZ IAS 18 paragraph 30).

If assets are received from a non-exchange transaction the following applies:

- Assets acquired through a non-exchange transaction shall initially be measured at their fair value as at the date of acquisition;
- An inflow of resources from a non-exchange transaction recognised as an asset shall be recognised as revenue, except to the extent that a liability is also recognised in respect of the same inflow; and
- As an entity satisfies a present obligation recognised as a liability in respect of an inflow of resources from a non-exchange transaction recognised as an asset, it shall reduce the carrying amount of the liability recognised and recognise an amount of revenue equal to that reduction.

4.3.2 Revenue and expense offsetting

Income and expenses shall not be offset unless required or permitted by a Standard or an Interpretation.

Departments undertake in the course of their ordinary activities transactions that do not generate revenue but are incidental to their main activities. The results of such transactions are presented, when this presentation reflects the substance of the transaction or other event, by netting any income with related expenses arising on the same transaction. This treatment is permitted under NZ IAS 1 *Presentation of Financial Statements,* paragraph 33.

Hence, if the department incurs an expense in anticipation of reimbursement, then any recovery must be recorded as a reduction in the expense. If, on the other hand, a department incurs an expense irrespective of any recovery, then the recovery is revenue to the department. For example, because the decision to claim (and award) legal costs is independent of the actual incurrence of those costs, income from court-awarded costs must be reported separately. On the other hand, discounts received are integral to the transaction and may be offset. This rule is used to determine the level of expense for appropriation purposes.

Departments should note however that NZ IAS 18 provides that revenue is measured at the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates allowed. Similarly any expenses should be reported net of any discounts received.

4.3.3 Capital charge

The capital charge is to be reported as an element of output expenses.

It is not to be accounted for as a financial instrument or a borrowing cost.

NZ IFRSs define what a financial instrument is and whether an instrument is a financial asset, financial liability or equity (these definitions are currently in NZ IAS 32 *Financial Instruments: Presentation*)). There were no equivalent definitions in current GAAP.

However, the definitions leave doubt as to whether capital charge is a financial instrument or related to a financial instrument.

The potential confusion surrounding capital charge was brought to the attention of the Financial Reporting Standards Board (FRSB). As a result, the FRSB (in its report to the Accounting Standards Review Board on NZ IAS 32 dated Oct 2004):

- noted that public sector capital charges represent a charge on the net assets employed by public sector entities, and do not relate to any financial instrument, either debt or equity, and that such an interpretation would be inappropriate;
- noted that the capital charge is designed to ensure that the costs of capital are included in the costs of services and to require that they be reported elsewhere would effectively thwart their purpose; and
- agreed not to include additional guidance for public benefit entities.

Accordingly, the capital charge is to be treated as an expense when entities are reporting to Treasury.

NZ IAS 23 *Borrowing Costs* states that “borrowing costs are interest and other costs incurred by an entity in connection with the borrowing of funds”. IPSAS 5 *Borrowing Costs*, which is based on IAS 23, states that “Where jurisdictions apply a capital charge to individual entities, judgement will need to be exercised to determine whether the charge meets the definition of borrowing costs or whether it should be treated as an actual or imputed cost of net assets/equity” (IPSAS 5 paragraph 4).

The capital charge, as applied to departments, is not a borrowing cost in accordance with NZ IAS 23.

4.4 Particular accounting policies: Statement of Financial Position items

4.4.1 Property, plant and equipment

The appropriate accounting treatment for items of property, plant and equipment is provided in NZ IAS 16 *Property, Plant and Equipment*. NZ IAS 16 does not apply to the following types of property, plant and equipment:

- property, plant and equipment classified as held for sale in accordance with NZ IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*;
- biological assets related to agricultural activity (see NZ IAS 41 *Agriculture*);
- the recognition and measurement of exploration and evaluation assets (see NZ IFRS 6 *Exploration for and Evaluation of Mineral Resources*); and
- mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources.

In addition, specific accounting policies apply to the following types of assets:

- investment properties (once initial construction or development is complete NZ IAS 40 *Investment Property* is relevant); and
- licences and patents (NZ IAS 38 *Intangible Assets* is relevant).

Departments involved in any of the above activities should consult with the Treasury.

NZ IAS 16 applies in part to leasehold interests in property and assets being acquired under hire purchase and other financing arrangements, including options and other rights to purchase such assets. However, departments are prohibited by the Act from entering into such arrangements by the Act unless approved by the Minister of Finance.

All individual assets or groups of assets must be capitalised if their historical cost is $NZ5,000 or greater. This threshold must be regarded as the upper limit. Departments may, with due consideration to their particular circumstances, set lower or multiple limits. However once established, these limits must be consistently applied in future periods. Where the value of items is less than $NZ5,000 (or such lower threshold as has been set by the department), assets must be expensed. However, where the value of an individual item is less than the threshold, but such item is part of a group of similar items (for example loose tools or instruments), these may either be expensed on purchase or be capitalised at an aggregate amount. In the latter case, cost is the initial purchase price of the class of items, with the cost of subsequent replacements being written off as they are acquired.

Where an item of property, plant and equipment that has been revalued is disposed of, any revaluation surplus in respect of that item of property, plant and equipment must be transferred from the revaluation reserve to Taxpayers' Funds.

4.4.2 Intangible assets

Intangible assets must be accounted for in accordance with NZ IAS 38 *Intangible Assets*.

Section 3.5.12 of Treasury Instructions ("Intangible Assets") sets out the key requirements of NZ IAS 38.

Additional guidance on the capitalisation thresholds for software and accounting for web site costs is provided in this section.

4.4.2.1 Computer software

Computer software must be classified as an intangible asset and accounted for in accordance with NZ IAS 38 unless it is an integral part of hardware, such as an operating system, in which case it is classified as property, plant and equipment and accounted for in accordance with NZ IAS 16.

The transaction costs associated with identifying and reporting the cost of internally generated software are likely to be significantly greater than the transaction costs associated with identifying and reporting the cost of other assets. As a result it is appropriate to apply a higher capitalisation threshold to these assets than other assets.

In determining whether the cost of an internal software development can be capitalised the requirements of NZ IAS 38 and NZ SIC 32 must be complied with. All individual software developments that meet these requirements must be capitalised if their historical cost is $50,000 or greater. This threshold must be regarded as the upper limit. Departments may, with due consideration to their particular circumstances and in particular considerations of materiality, set lower limits. However once established, these limits must be consistently applied in future periods. Where the value of items is less than $NZ50,000 (or such lower threshold as has been set by the department), the costs of internally generated software developments must be expensed.

In determining whether software development costs, including upgrades, should be capitalised, departments' attention is drawn in particular to the following requirements paraphrased from NZ IAS 38 and NZ SIC 32:

- Costs associated during the research phase of a software development should not be capitalised, but must be expensed (NZ IAS 38 paragraph 54). Activities occurring in the research phase include the search for and selection of alternatives (NZ IAS 38 paragraph 56).

- Software development can only be capitalised if it is technically feasible to complete the development, the software is intended to be, and can be, used or sold, if the usefulness or market value of the software can be demonstrated, and if the expenditure attributable to the software development can be measured reliably (NZ IAS 38 paragraph 57).

- The cost of a software development includes costs of materials and services used or consumed in generating the software, employee costs including the cost of employee benefits, fees to register the software, and amortisation of patents and licences used to generate the software (NZ IAS 38 paragraph 66).

- The cost of a software development does not include overhead expenditure, identified inefficiencies and initial operating costs incurred before the software achieves planned performance, and expenditure on training staff to operate the asset (NZ IAS 38 paragraph 66).

- The nature of intangible assets is such that, in many cases, there are no additions to such an asset or replacements of part of it. Accordingly most subsequent expenditures are likely to maintain the future economic benefits or service potential embodied in an existing intangible asset rather than meet the definition of an intangible asset and the recognition criteria (NZ IAS 38 paragraph 20).

In determining whether the usefulness or market value of the software can be demonstrated reference should be able to be had to a business case where measurable economic benefits or service potential from the development are identified.

In determining whether subsequent expenditure on software represents an addition to the software the following factors are likely to be useful in making a judgment as to whether the subsequent expenditure should be capitalised:

- Conventional maintenance that does not change the characteristics of the software does not create additional benefits or service potential and should be expensed.

- Changes to software that permit it to be used in the same way under normal operating conditions, such as Y2K type modifications or repairing faults introduced by bugs, should not be capitalised.

When software is updated or upgraded, the costs of the upgrade should only be capitalised when the increased usefulness or increased market value of the software can be demonstrated.

4.4.3 Provision for return of operating surplus

Section 22(1) of the Act states that “Except as agreed between the Minister and the Responsible Minister for a department, the department must not retain any operating surplus that results from its activities”.

The calculation of the provision for the operating surplus to be paid to the Crown is:

	Net surplus before “other expenses”
Plus	**Sum of all deficits incurred from providing goods and services under section 21 of the Act in that year**
Plus (minus)	**Any unrealised losses (gains) in relation to forward foreign exchange contracts or other derivative transactions recognised in the Statement of Financial Performance in that year**
Plus (minus)	**Any decrease (increase) in an item of property, plant and equipment’s carrying amount that is recognised in the Statement of Financial Performance as a result of a revaluation of an asset or class of assets in that year**

The rationale for the adjustments to the operating surplus is as follows:

- Other expenses are excluded from surpluses to be returned to ensure that operating activities are not subsidising, or being subsidised by, ownership actions or decisions.

- Some departments have been granted approval, under section 21 of the Act, to incur output expenses up to the amount of revenue expected to be earned by that class of outputs from parties other than the Crown. Deficits associated with any approved section 21 activities are added onto the operating surplus to avoid subsidisation by the Crown of third party activities.

- Unrealised remeasurements that are reported in the Statement of Financial Performance primarily relate to unrealised foreign exchange gains and losses, and impairments of property plant and equipment. Such items are not intended to affect the surplus repayable.

Departments need to make a provision for the repayment of their surplus in their Statement of Financial Position. The recognition of a provision for repayment of surplus is in accordance with NZ IAS 10 *Events After Balance Sheet Date*. The obligation to repay the surplus is a condition that existed at the balance date.

Payment of surpluses is to be made by 31 October following the end of the financial year.

Requests to retain surpluses should be sought from the Responsible Minister and forwarded to the Minister of Finance as soon as the amount to be retained is known. Requests are to be made no later than three weeks after the year-end.

The agreement of the Minister of Finance and Responsible Minister is required before a department can retain any operating surpluses (section 22(1) of the Act refers).

Departments seeking approval to retain surpluses need to explain why this approach is more appropriate than seeking a capital injection. Departments should discuss the intention to seek approval to retain surpluses with their Vote Analyst.

4.4.4 Liability for capital withdrawals

Where a department forecasts a capital withdrawal leading to a reduction in equity in the Estimates, the level of projected net assets will be higher at the start of the year than would otherwise be permitted during the year. To ensure that a breach of the Act does not occur on the passing of the Appropriation (Main Estimates) Act, the amount and timing of any capital withdrawal in a financial year included in the net assets schedule presented with the Estimates of Appropriations must be agreed between Treasury and the department prior to the passing of the Appropriation (Main Estimates) Act for that year. The requirement that the projected level of net assets set out in the Appropriation (Main Estimates) Act is not exceeded, combined with the obligation created by the agreement over the amount and timing of repayment of equity, creates an obligation to make repayment of equity during the year and therefore a liability for capital withdrawal.

Following the passage of the Appropriation (Main Estimates) Act for a financial year, departments that forecast capital withdrawals during that year in that Appropriation (Main Estimates) Act, and that have agreed the amount and timing of repayment of the equity with the Treasury, must recognise a liability to the Crown in the Statement of Financial Position until the capital withdrawal has occurred.

4.4.5 Commitments

Commitments are future expenses and liabilities to be incurred on contracts that have been entered into at balance date.

Information on non-cancellable commitments must be disclosed in the Statement of Commitments.

Cancellable commitments that have penalty or exit costs explicit in the agreement on exercising the option to cancel must be included in the Statement of Commitments at the value of that penalty or exit cost (i.e. the minimum future payments).

Commitments must be classified as:

- **Capital commitments: aggregate amount of capital expenditure contracted for but not recognised as paid or provided for at period end.** NZ IAS 16 (paragraph 74(c)) requires the disclosure of contractual commitments for the acquisition of property, plant and equipment.

- **Non-cancellable operating leases with a lease term of more than one year (as required by NZ IAS 17 *Leases*). These must be classified into liabilities due under the lease in the following periods:**

  – **not later than one year;**

  – **later than one year and not later than five years; and**

  – **later than five years.**

- **Other non-cancellable commitments: these may include consulting contracts, cleaning contracts and ship charters. These must be classified into liabilities due in the following periods:**

  – **not later than one year;**

  – **later than one year and not later than five years; and**

  – **later than five years.**

Interest commitments on debts and commitments relating to employment contracts must not be included in the Statement of Commitments.

4.5 Forecasting Policies

This section sets out requirements in policies with regard to forecasting.

4.5.1 General forecasting policies

Forecasts are to be prepared on the basis of best professional judgment. Appropriate quality analysis of the forecast is required before submitting to Treasury.

For departments, forecasts should be based on expected results rather than appropriation limits. Typically, expenditure forecasts should be less than approved appropriation levels (which are maximum levels).

Entities should confirm material forecast inter-entity balances (i.e. over $10m) with the counter-party. Both sides to a material inter-entity transaction must have the same basis for their forecasts.

In general, forecasts of assets and liabilities should use the valuations as recorded in the Financial Statements of the Government for the prior year and any additional valuations that have occurred up to the forecast reference date. As a consequence, no further realised or unrealised gains or losses are forecast for the entire forecast period. An exception to this general policy is that expected physical growth changes in agricultural assets should be forecast.

4.5.2 Forecasting policies for financial assets and liabilities

Forecast sales and purchases of bonds and other liquid instruments are assumed to be issued at par value, with no discounts or premiums forecasted. Generally, financial assets and financial liabilities held at the forecast reference date are assumed to be held until they mature.

Forecasts of instruments that have non-market elements (e.g. low or no interest rates with long maturities such as student loans or social benefit receivables) should include the forecast write-down to fair value on initial recognition and the revenue from the effective interest unwind.

Interest income and interest expense is recognised using the effective interest rate method (which in most instances will equal the coupon rate for future instruments).

Forecasts use the exchange rates, interest rate curves and electricity pricing curves prevailing at the forecast reference date. As a consequence, no additional realised or unrealised foreign exchange gains or losses are forecast for the entire forecast period.

Gains and losses reflect long run rate of return assumptions appropriate to the forecast portfolio mix, after adjusting for interest income and interest expense (recognised separately using the effective interest rate method).

4.5.3 Forecasting policies for derivatives

Only the value of derivatives as at the forecast reference date may be realised – no additional realised or unrealised derivative gains or losses are recognised over the forecast period. Forward margins on forward foreign exchange contracts existing at the start of the forecast period are amortised over the period of the contract on a straight line basis.

Forecasts for derivatives should only include those that exist at the forecast reference date, and then only to their maturity. That is, by the end of the forecast period only those derivatives existing at the forecast reference date with a maturity beyond the end of the period should be recognised in the financial statements.

Future derivative activity should not be included in forecasts. This is because fair value forecasts of future derivatives is zero due to forecast exchange rates being fixed at the rate at the forecast reference date, as are interest rate curves and other assumptions (e.g. electricity pricing curves) affecting the value of derivatives.

4.5.4 Forecasting policies for property plant and equipment

Forecasts of the value of property, plant and equipment (including state highways and rail infrastructure), must use the valuations as recorded in the Financial Statements of the Government for the prior year and any additional valuations that have occurred up to the forecast reference date. As a consequence, no further realised or unrealised gains or losses are forecast for the entire forecast period.

Entities should review forecasts for the purchase of physical assets to ensure they show a realistic profile across all forecast years (analysis of prior year forecasts shows forecasts for purchases of such are typically below actual results).

4.5.5 Other forecasting policies

Forecast operating lease revenues and expenses are recognised in a systematic manner over the forecast term of the lease.

The cost of forecast leasehold improvements is capitalised and amortised over the forecast unexpired period of the lease or the estimated useful life of the improvements, whichever is shorter.

5 Operating instructions: Cost accounting policy parameters

5.1 Disclosing cost accounting policies

The Act requires departments to:

- identify in the Estimates and other supporting documents the expenses (or forecast expenses) to be incurred for each class of outputs to be supplied by the department (sections 14(1)(a) and 15(1)(c));
- identify in the Statement of Forecast Service Performance the proposed output expenses to be incurred for each class of outputs (section 41(1)(e)(iii)) prepared as part of information on the future operating intentions of the department; and
- compare in the Statement of Service Performance actual output expenses incurred with the output expenses that were forecast in the Statement of Forecast Service Performance (section 45A(c)(ii)) prepared as part of the annual report of the department.

The accuracy and reliability of output expenses are determined by the cost accounting policies that each department has followed. If users of financial reports are to understand output expenses fully, financial reports must inform users of those policies, any changes to them, and what effects those changes of policy have had.

Departments must include a clear and concise statement of cost accounting policies in external financial reports.

The objective of disclosing cost accounting policies is to provide users of financial reports with sufficient information to:

- understand the significance of the output cost information;
- be confident that the information is reliable, relevant and not misleading; and
- determine whether the report is comparable with those of other periods and other departments.

The statement of cost accounting policies in external financial reports must disclose:

- **all the significant cost accounting policies used in estimating, accumulating and reporting output costs; and**
- **any material changes to those policies.**

The disclosure must comprise:

- **a statement specifying the criteria for distinguishing between direct and indirect costs;**
- **a statement about the methods of attributing direct costs;**
- **a statement about the bases for allocating indirect costs; and**

- **a statement of any changes in cost accounting policies since the date of the last external financial report or, if there have been no changes, a statement to that effect. If the changes made materially affect the cost of individual outputs, there must be full disclosure of:**
  - **the nature of the changes;**
  - **the reasons for the changes; and**
  - **the effect of the changes on individual outputs.**

Departments supplying contestable outputs may apply to the Treasury for a modified disclosure.

5.2 Documenting cost accounting policies

Chief Executives must ensure that cost accounting practices are formalised and properly documented, and sufficiently detailed to enable him or her to:

- **satisfy his or her obligations under the State Sector Act 1988 and the Public Finance Act 1989;**
- **satisfy the management information requirements of Chief Executives and departmental managers; and**
- **achieve the standard required to:**
  - **satisfy the scrutiny of the Audit Office; and**
  - **enable the Treasury to assure the Minister of Finance that the output cost information is reliable.**

To satisfy these requirements, it would generally be expected that the cost accounting system should be able to produce a reliable average and marginal cost-per-unit of standardised goods and services that are regularly delivered by the department.

When documenting departmental cost accounting policies, the format and level of detail are left to the discretion of each Chief Executive, but the documented cost accounting policies must cover the:

- **methods of classifying direct and indirect costs;**
- **methods of attributing direct costs;**
- **bases for allocating indirect costs;**
- **procedures for updating cost accounting policies; and**
- **procedures for self-reviewing cost accounting systems.**

Cost accounting is a formal discipline. Structures and procedures must be followed if information is to be credible and transparent. A proper documentation of this process will include definitions, rules and procedures, and ensure that:

- agreement on major definitions is formalised;

- practices are applied correctly and consistently;
- knowledge can be reliably transferred; and
- audit trails are provided.

5.3 Classifying direct and indirect costs

There are many ways of classifying costs that have proven useful for various purposes. **For the purposes of output costing, output purchase contracting and output reporting, cost classification must focus on assigning costs to outputs.** This involves the cost accounting policy of distinguishing between direct and indirect costs.

Where costs are treated sometimes as direct, and sometimes as indirect, departments must set out the criteria and circumstances that govern the distinction.

Departments must establish a written policy about how direct and indirect costs are to be distinguished for the purpose of assigning costs to outputs. The criteria used to classify costs as direct or indirect must be based on whether the cost can be causally linked and assigned to an output in an economically feasible manner.

To increase the accuracy and reliability of output costing, departments must review and formalise their definition of direct costs. They must not adopt the convenient approach of grouping direct costs into an indirect cost pool, and then allocating the whole by calling it overheads.

Departments may decide how detailed the classification of costs ought to be, but must disclose separately how each major cost grouping was classified.

5.4 Bases and methods of assigning costs to outputs

5.4.1 Introduction

The Government allocates resources to departments on the basis of their outputs. **Departments must estimate, accumulate and report output costs in a manner consistent with this method of resource allocation.**

5.4.2 Assigning expenses

When estimating, accumulating and reporting output costs for external financial reports, departments must assign all operating costs (that is, both direct and indirect costs) to outputs. They must not assign "other expenses", as defined in the Act, and as further discussed in section 5.6 of these Instructions ("Departmental other expenses") to outputs.

5.4.3 Attributing direct costs

Direct costs that are attributed to outputs must be based on actual consumption. Pre-established bases or ratios may be used, if departments are able to prove these fully represent actual consumption.

5.4.4 Allocating indirect costs

Where services are provided to more than one output at the same time, the cost must be divided and allocated to each output in reasonable proportion to its actual consumption.

Departments may accumulate indirect costs into “homogeneous” cost pools. An indirect cost pool is “homogeneous”, if the activities whose costs are included have similar causal relationships to the production of the outputs.

Departments must allocate indirect cost pools to outputs by appropriately measuring resource consumption.

Pre-established rates may be used in allocating indirect cost pools, if departments can prove that these fully represent actual consumption.

5.4.5 Pre-established rates

When a department uses pre-established rates to assign direct and indirect costs to outputs, it must have a written policy for establishing the rates. The rates must be reviewed at least annually, and revised to reflect the anticipated conditions. If the revision occurs during a cost accounting period and there are significant variations, the costs assigned to that period must be adjusted to the amounts that would have been allocated using the revised rates.

5.5 Consistency in applying cost accounting policies

5.5.1 Introduction

Consistency in applying cost accounting policies enables similar transactions to be treated alike. This improves comparability between estimated and actual costs, and with other periods and departments. Such comparisons provide a basis for financial control, cost accountability and evaluating estimation capabilities.

The following sections provide criteria to ensure that departments are consistent when estimating, accumulating and reporting costs, both within and between financial years.

5.5.2 Consistency

A department's cost accounting policies must be consistent, both for estimating costs for external ex-ante reports and for accumulating and reporting actual costs for external ex-post reports.

A department's cost accounting policies must normally not change from one reporting period to another, and must be applied to all cost items of a similar nature.

5.5.3 Changes in cost accounting policies

A department may change its cost accounting policies during the financial year, only if the new policies better reflect its cost behaviour and underlying activities. When such a change is made, the department must provide full disclosure as that phrase is described in section 5.1 of these Instructions ("Disclosing cost accounting policies").

5.6 Departmental other expenses

5.6.1 Introduction

The Act (section 2) defines other expenses as "any expenses incurred by the Crown, a department, or an Office of Parliament that are other than:—

(a) output expenses;

(b) benefits or other unrequited expenses; or

(c) borrowing expenses.

The Act (section 2) states that output expenses "(a) includes the full cost of producing and supplying outputs measured in accrual accounting terms and (b) includes the full allocation of overhead costs".

Departmental Other Expenses are therefore costs which are not incurred by a department in the production of its outputs. Generally, all costs incurred in the normal course of a department's business (i.e. output production) will be output expenses. The fact that a cost is unusual, unexpected or large does not, by any or all of those reasons only, mean that it is precluded from being defined as an output expense.

The Other Expenses appropriation was introduced because there were a number of costs which could not reasonably be associated with the production of outputs (and would normally result in a loss of value to the "owner"). Therefore, the key factor in determining whether an expense must be classified as an output expense or an Other Expense is whether the expense was incurred for the production of outputs or for other non-output related activities. This factor will result in some expenses being considered output expenses under certain circumstances and Other Expenses in other cases.

Examples of this are discussed in the following sections.

5.6.2 Loss on sale of assets

Losses arising from the sale of standard items of property, plant and equipment (for example photocopiers and fleet vehicles) must be treated as an output expense, because the loss arose out of the normal replacement or upgrade of an item of property, plant and equipment. However losses arising from the sale of surplus assets (because for example the department is no longer producing certain outputs as a result of restructuring) must be treated as an Other Expense, because the loss does not relate to the goods and services the department is currently producing.

5.6.3 Asset devaluations

Expenses arising from the devaluation of assets (where there are insufficient revaluation reserves) must be treated as Other Expenses, only if the assets concerned are not used in the production of outputs. Asset devaluation expenses must generally be considered output costs because departments will normally only hold assets necessary for the production of their outputs. The burden of proof lies with departments to demonstrate that any asset devaluation expenses relate to non-output assets and therefore must be considered Other Expenses.

5.6.4 Restructuring expenses

Other Expenses are most likely to arise when departments undergo restructuring. For restructuring costs to be considered an Other Expense, they would need to relate to decisions by the Government that departments cease producing (or being responsible for producing) certain outputs. Minor adjustments to staffing numbers or alterations to the resource mix used to produce an output (for example contracting out versus in-house production) do not constitute restructuring costs for Other Expense purposes.

Restructuring expenses (whether they are output costs, or Other Expenses, or both) must be recognised by way of a provision when a liability arises. In most cases this will be when a final decision to restructure is made and announced. The provision for restructuring costs must reflect the total costs of the restructuring irrespective of when the restructure is to take effect or payments are to be made.

5.6.5 Disclosure of other expenses

Departments must disclose the nature of other expenses.

A department may not classify any items of income or expense as extraordinary items (NZ IAS 1 paragraph 85).

Where other expenses relate to non-current assets (or disposal groups) which have been either classified as held for sale or sold, the disclosure requirements of NZ IFRS 5 are relevant.

5.6.6 Summary

In summary, departmental Other Expenses are likely to include:

- restructuring costs, but only where these relate to decisions to cease producing certain outputs;
- loss on sale of assets where this arises from the sale of assets made surplus from decisions by the government to cease producing certain outputs; and
- asset devaluation expenses where these relate to non-output items.

5.7 Definition of terms

Allocating costs means assigning costs to cost objects using measures that are not directly related to the cost object's level of resource consumption.

Assigning costs means the general procedure for tracing costs to cost objects.

Attributing costs means causally assigning costs to cost objects based upon resource consumption.

Class of outputs is a grouping of similar outputs for appropriation or non-financial reporting purposes.

Cost accounting policies are the rules and procedures that form the basis for estimating, accumulating and reporting output costs for both ex-ante and ex-post financial reports.

Cost objects are the elements to be costed in a costing exercise. They can be a cost centre, an output class, an output, a sub-output or an activity.

Direct costs are costs that can be identified with an output in an economically feasible manner. They are causally related to, and readily assignable to, an output.

Expenses are any expenses incurred by a department, including cost. They are measured in accrual accounting terms.

Homogeneous cost pools are pools of similar costs that have been grouped for the purpose of allocation. The pools contain the costs of activities that have a similar causal relationship to the production of outputs.

Indirect costs are costs that cannot be identified with an output in an economically feasible manner. They are incurred for the common benefit of more than one output.

Major cost groupings are sets of similar costs that have been grouped for the purposes of reporting, and assigning costs to, outputs.

Outputs are the goods and services supplied by a department to an external party, including those that have been agreed or contracted to supply on a contingent basis, but that have not been supplied.

6 Operating instructions applying to departments as defined in the Public Finance Act 1989

6.1 Financial responsibility of Chief Executives

Section 34 of the Act makes departmental Chief Executives responsible for the financial management and financial performance of their departments.

Chief Executives are responsible for operating their own accounting and management systems and establishing day to day procedures to support those systems.

Specific responsibilities, which must be addressed by Chief Executives, include:

- **financial reporting requirements;**
- **the system of internal control;**
- **responsibility for non-statutory bodies;**
- **banking, receipt and payment systems;**
- **accounting systems;**
- **control over asset acquisition, utilisation and disposal;**
- **purchasing, contracting and tendering procedures;**
- **risk management;**
- **travel policies and procedures;**
- **personnel policies and procedures; and**
- **foreign exchange exposure management.**

A number of publications have been developed to assist departmental Chief Executives with the development and maintenance of appropriate accounting policies and systems. Departments may obtain these publications from their Vote Analysts.

The Chief Executive's responsibilities must be carried out within the parameters of legislation and Government policy. The requirements of the Act, the State Sector Act 1988, Treasury Instructions, Minister of Finance Instructions and any other legislation or regulations governing the operations of the department must be complied with. These requirements may result in departments having responsibilities to parties other than the Crown. Government policy, as set out in Cabinet decisions, Ministerial direction, or agreements between the Chief Executive and the Responsible Minister may also impact on the manner in which the Chief Executive meets his or her responsibilities. Financial delegations from Cabinet to the Responsible Minister and the Chief Executive are a specific example of Cabinet decisions that impact upon financial management within a department.

In addition to responsibilities associated with the financial management of the department, the Chief Executive may be responsible for incurring expenditure, collecting revenue, or managing assets and liabilities on behalf of the Crown, or for managing trust money on behalf of the Treasury (which manages it for the Crown).

6.2 Reporting obligations

6.2.1 Annual financial statements of departments

6.2.1.1 Reporting requirements

Section 45B of the Act sets out the requirements for preparation of the annual financial statements of departments. They must be prepared in accordance with generally accepted accounting practice as defined by section 2 of the Act; and include:

- any other information or explanations needed to fairly reflect the department's financial operations and financial position;
- the forecast financial statements prepared at the start of the financial year for comparison with the actual financial statements;
- a statement of actual expenses and capital expenditure incurred against each appropriation administered by the department and each class of outputs included in each output expense appropriation; and
- a statement of unappropriated expenses and capital expenditure incurred in relation to the activities of, or appropriations administered by, the department together with an explanation of the reasons for the unappropriated expenses and capital expenditure.

6.2.1.2 Non-departmental activity

A number of departments administer non-departmental activities on behalf of the Crown. Although departments are not directly accountable for the financial performance of non-departmental activities, the department is responsible for the effective and efficient administration of these activities. The provision of information on the financial extent of these activities will provide context for, and supporting information regarding, departmental outputs, and is necessary to reflect the financial operations of the department for the year and its financial position at the end of the year.

Departments therefore must disclose non-departmental activities in the form of schedules. If applicable and appropriate, departments must have up to six separate sets of schedules for assets, liabilities, income, expenses, contingencies and commitments (if not fully disclosed in the statement reporting expenditure or expenses or liabilities incurred against appropriations). Departments must also provide a statement regarding the accounting policies used in preparing the schedules, to the effect that measurement and recognition rules consistent with generally accepted accounting practice are applied in the preparation of the schedules. The schedules are to be audited.

6.2.2 Provision of reports to Ministers

Chief Executives must provide regular financial and performance information to their Responsible Minister, and to Ministers responsible for Votes administered by their department. These reports must, if requested, be made available to the Treasury.

Although the format and timing of this information is at the discretion of Ministers and departments, Cabinet has directed that five principles should be adhered to when preparing this information. These principles are:

- *No surprises:* Ministers should expect to be adequately warned in advance of any issue of significance, for example, if there is any risk that appropriations may be breached.

- *Linked to other reporting:* Performance information should be linked to Ministerial priorities, and should therefore link to any communications from Ministers that express those priorities. Such information should also be consistent with measures of performance included in the information supporting the Estimates of Appropriations, Statement of Intent and Annual Report.

- *Materiality:* The level of detail should be appropriate. The issue of materiality should consider both the dollar value of financial information and whether the information is significant for other reasons.

- *Forward Looking:* A common criticism of reporting is that information is historic and often simply describes what has already occurred. Reporting should also make projections of future situations and compare these with what was planned. Where variances indicate that remedial action is required, departments should clearly identify areas in which ministers are required to make decisions. Decisions contained within a report should be distinguished from information provided purely for the minister's information.

- *Exceptions Basis*: Exceptions reporting focuses on areas where performance has departed or is anticipated to depart from agreed performance expectations.

6.2.3 Provision of reports to the Treasury

The Treasury is responsible for reporting aggregate financial information to the Minister of Finance. The Secretary to the Treasury requires assurance that there is an adequate system of internal control in place in departments, and that the departmental information used in this reporting can be relied upon.

In addition, the role of the Treasury in preparing forecasts and actual financial statements means that the Treasury also requires timely information in specified formats. Chief Executives must supply timely and accurate information to the Treasury for the following purposes:

- **preparation and compilation of the Budget and the Estimates of Appropriations, Information supporting the Estimates of Appropriations, supplements, and adjustments to these;**

- **budget and appropriation monitoring;**

- **monitoring and control of Crown revenue, expenditure, assets and liabilities (refer also to section 6.4 "Crown revenue, expenditure, liabilities and assets");**

- **forecasting and monitoring of banking activity (refer also to section 6.5 "Banking");**

- **monitoring and control of trust money (refer also to section 6.6 "Trust money");**

- **monitoring and control of contingent liabilities (refer also to section 6.7 "Contingent liabilities"); Preparation of the financial statements of the Government of New Zealand; and**

- **explanation of material variances to forecast.**

Such information must be provided by way of reports in the form, and within the time frame, from time to time specified by the Treasury. These requirements are set out in Treasury Circulars.

6.2.4 Compliance with accounting and forecasting policies

All reports supplied to the Treasury must be prepared in accordance with the relevant accounting and forecasting policies issued by the Treasury. In the case of departmental activity they are the "Accounting and forecasting policy parameters for external financial reporting by departments" (section 4 of the Treasury Instructions). In the case of Crown activity managed by the department, reports are to be prepared in accordance with the "Crown accounting policies for external financial reporting" (section 3 of the Treasury Instructions).

6.2.5 Provision of other information

Section 79 of the Act provides the legal authority for the Treasury to request information from departments (except an intelligence and security department unless the Secretary and the Chief Executive of that department agree or, failing that, the Minister and Responsible Minister jointly decide that the Treasury may make the request) in relation to the financial management, financial performance, or banking activities of a department, or in relation to the management or control of any Crown asset or liability.

Chief Executives must supply such information or access as the Treasury may from time to time require for the purpose of examining the accuracy of information provided to the Treasury or the integrity of the financial management system operating in a department.

6.3 Departmental revenue, expenditure, assets and liabilities

6.3.1 Managing departmental expenditure

A key principle of the appropriation process is that expenses and/or capital expenditure may not be incurred without prior legislative approval. In addition to such statutory authority, all expenses and/or capital expenditure may be incurred only in accordance with the most recent Cabinet Office Circular on delegations for expenditure and limits on expenditure authority. The Imprest Supply and supplementary estimates processes are designed to allow some flexibility for government and departments to alter resource allocations while still maintaining prior parliamentary legislative approval and scrutiny.

Under these processes, no expenses or capital expenditure additional to, or in excess of, appropriation may be incurred without prior Cabinet approval. Any such approval is:

- for an appropriation for expenses or capital expenditure;

- to include these appropriations in the next set of Estimates; and

- to meet such expenses or capital expenditure from Imprest Supply.

An alternative mechanism, that of transferring an amount appropriated in a Vote for a specified class of outputs in that Vote to another class of outputs in that Vote, is permitted under section 26A of the Act. This transfer can be either during or after the financial year, provided that it is the only transfer to that appropriation for the year, that the amount transferred does not increase the appropriation by more than 5%, and that the total amount appropriated for that financial year for all output expense appropriations in that Vote is not altered. An Order in Council is required to effect such a transfer.

6.3.2 Expenditure requiring Minister of Finance approval

Both emergency expenditure and unappropriated expenditure require the approval of the Minister of Finance.

Emergency Expenditure: Section 25 of the Act provides authority for the Minister of Finance to approve the incurring of expenses or capital expenditure necessary in the event of a defined emergency.

The Government's policy on civil defence expenditure is contained in the National Civil Defence Plan, published by the Ministry of Civil Defence and Emergency Management.

The Government's policy on search and rescue expenditure is contained in the National Search and Rescue Manual published by the Ministry of Transport. Early notification by a department to the Treasury will help ensure rapid approval is obtained from the Minister in the event of any such emergency.

The Treasury will prepare a report to the Minister to approve emergency expenditure. Therefore details of any such intended expenditure must be supplied by the department concerned to the Treasury prior to the expenditure being incurred.

Expenditure in excess of an existing appropriation: Section 26B of the Act provides authority for the Minister of Finance to approve the incurring of expenses or capital expenditure in the last three months of the financial year, in excess of appropriation by Parliament, up to the greater of $10,000 or 2% of the total amount appropriated for costs for that Vote for that financial year.

The Treasury must prepare a report to the Minister for each case of unappropriated expenditure; therefore details of any such expenditure must be supplied by the department concerned to the Treasury in accordance with the timetable that is notified annually to departments.

6.3.3 Foreign exchange exposure management

Section 65F of the Act provides that it is not lawful for the Crown (which includes a department of the Crown) to enter into a derivative transaction except as provided in any Act. Section 65G of the Act provides the Minister of Finance may enter into a derivative transaction if it appears to the Minister to be necessary or expedient in the public interest to do so. Section 2 of the Act provides a derivative transaction includes a foreign exchange transaction. A department's foreign exchange exposure management is conducted in accordance with its Departmental Foreign Exchange Exposure Management Policy, and operates on the basis of delegation from the Minister of Finance through the Treasury. The guidelines for the Management of Departmental Foreign exchange Exposure (first issued 1990, updated 2003) assist departments in preparation of their Foreign Exchange Policy Document.

If a department's Foreign Exchange Exposure Management Policy is not within the guidelines it must be agreed between the Responsible Minister and the Minister of Finance.

6.3.4 Departmental insurance and risk management

Departments must carry out some form of systematic risk management process covering:

- **identification of the risks faced, or likely to be faced;**
- **quantification of the type and size of the risk (including consideration of prior losses and probability of loss);**
- **determination of a risk appetite (i.e. the amount of risk the department is prepared to accept); and**
- **deciding how the risks are to be managed or controlled, including whether to purchase insurance cover.**

Each department is likely to approach this task differently to others, and will arrive at different conclusions based on their business profiles and risk exposures. Regardless of the process chosen, the critical element is that accountability for managing risk is established within the department, and that procedures are in place to maintain it as a high priority throughout agency operations.

The full range of options for the treatment of risks should be canvassed before decisions are made. The options available can be defined as:

- Tolerate – an assessment of the costs to manage or mitigate a risk may outweigh the benefits to be gained, so a decision is made to accept the risk as it stands.
- Treat – internal systems or processes are put in place that reduce the risk to suitable levels (i.e. installing sprinkler systems).
- Transfer – an external party takes on the risk, most commonly by way of commercial insurance.
- Terminate – the activity being undertaken or contemplated is stopped due to the risks being too high.

Departments are not obliged to insure against all their risks. Rather, they are required to systematically assess all risk management options available to them, of which insurance is only one. Decisions on the management of risks are likely to be made according to the probability and size of any loss, and the department's ability to absorb any potential loss. This is especially the case for decisions on self-insurance, where the department needs to be certain that it has the operational and financial ability to absorb any loss.

In the rare circumstance that a significant identified risk cannot be managed by a department (including by way of self insurance or commercial insurance), this is to be quantified and reported to the responsible Minister and the Minister of Finance. This is likely to arise in situations where the insurance market is unwilling to take on the risk (for example, war time insurance of military assets), and where mitigation efforts are not deemed to be cost-effective or appropriate.

Options such as self-insurance by the department should be explored and costed before raising the issue with Ministers. This will include consideration of whether the department has the operational and financial capability to handle any loss, and the impact this would have upon producing outputs and achieving outcomes.

It is important that insurance and risk management arrangements are regularly reviewed. This ensures that relevant factors from the changing business environment are taken into account, and that best practice improvements are being implemented or adapted.

The Crown owns other assets which are not recorded in departmental balance sheets (for example, Parliament buildings). The general policy for these Crown assets is self-insurance. Departments managing Crown assets (particularly assets with substantial and special value) should continue to review the risks faced by those assets and advise the responsible Minister(s) as to the most effective courses of action. In the case of buildings, for example, this may include increasing strengthening or mitigation strategies within buildings against catastrophic events such as earthquake or fire.

6.3.5 Prohibition on investing, borrowing or lending

Departments must not invest surplus cash balances unless it is under a delegation from the Treasury. Investing includes the purchase of shares or equity in another organisation.

Under section 65I of the Act, investing of public money in bank deposits with a bank approved by the Minister for the purpose, public securities, and other securities approved by the Minister for the purpose, may be undertaken by the Treasury.

Under section 65K of the Act the Crown must not lend money to any party except as expressly authorised by any Act or if lending the money is necessary for the Crown to meet a legal obligation or to perform a function properly. For the purposes of this Instruction, loans made to employees as part of their remuneration agreements, or the provision of credit for the supply of goods and services for periods of less than 90 days are regarded as necessary for the Crown to properly perform a function, and are therefore permitted under the Act.

Under section 46 of the Act the Crown (including departments) must not borrow money nor must any person lend money to the Crown, unless authorised by any Act. The term “borrow money” includes entering into hire purchase or agreements that are of the same or a substantially similar nature (e.g. those involving deferred payments), finance leases or arrangements that are of the same or a substantially similar nature, obtaining goods and services (including fixed assets) on credit for periods greater than 90 days and accepting debt on assignment from other persons (i.e. recording the indebtedness of another entity in the accounts of the department and paying those debts as if they were the debts of the department). Under section 47 of the Act the Minister of Finance may borrow money on behalf of the Crown if it appears to the Minister to be necessary or expedient in the public interest to do so.

6.3.5.1 Obtaining authority to enter into finance leases

A finance lease is a form of borrowing and the general prohibitions on borrowing also apply to finance leases.

Departments must obtain approval before entering into any finance lease.

Departments may seek approval for entering into finance leases by either:

- seeking specific approval from the Minister of Finance for a specific lease. In this case the Minister signs the lease and the department administers it on the Minister's behalf. This approach is most useful for one-off arrangements that are less likely to be renewed; or

- seeking a pre-determined level of borrowing ability as an agent in accordance with requirements outlined in section 50 and section 53 (if relevant) of the Act. Departments must provide a paper to the Treasury seeking authority to enter into finance leases. This approach is most useful where the number, quantum and timing of leases may change regularly (for example, IT leases). In order to deal with such changes the use of pre-determined levels within which the department has flexibility to alter leasing arrangements are likely to be appropriate. Any borrowing limit must be consistent with the limits in CO(99)7 in relation to purchase, development or leasing of fixed assets.

When seeking delegated authority to enter into finance leases departments must provide a paper setting out the following information:

- **the parties to the lease and their legal jurisdiction;**

- **the nature of the request (one-off lease approval or authorised limit to enter finance leases up to a certain nominal value);**

- **what the finance leases will be for (e.g. IT equipment);**

- **the expected costs and benefits of using finance leases as opposed to operating leases or outright purchase, including the discount rate used; and**

- **relevant information on contingent liabilities/assets (e.g. indemnities/options).**

Where information on the following factors is relevant it should also be included:

- taxation implications for all counter-parties to the lease;

- evaluation of counter-party credit risk, such as what happens if one party defaults on contractual obligations;

- the extent of foreign exchange rate exposure, if any, and who will manage this; and

- details of the arbitration authority if any.

The Treasury, in advising the Minister of Finance, will consider factors such as:

- costs from the Crown's point of view, not just the department's (albeit departments are required to manage all cash flows associated with potential finance leases from existing baselines);

- the potential increased costs in comparison with other sources of finance, the duration of the arrangement, cost of exiting the arrangement and whether the advantage leveraged by a department is at the expense of other areas of the Crown (for example if a favourable finance rate was levered off the New Zealand tax base); and

- the increased risks from the negative impact on other areas of fiscal or financial policy (for example implications of any cross default clauses or overall gross debt targets of the Crown).

The department's request to the Treasury will form the basis of a joint Treasury and department Report to be sent to the Minister of Finance advising of the request for authority, and Treasury's recommendations in relation to it. A borrowing agent's warrant will be attached for the Minister to formally sign and will then be returned to the department.

6.3.6 Memorandum accounts

Memorandum accounts are notional accounts which record the accumulated balance of surpluses and deficits incurred in the provision of certain outputs on a full cost-recovery basis. They are not formal assets or liabilities of the Crown.

In general, full cost-recovery (including the capital charge) applies where departments supply services to third parties in the absence of competition or under a statutory monopoly. Departments should ensure that fees and charges do not differ so far from cost that demand for the service is substantially affected.

Except where prior approval for alternative arrangements has been obtained from Treasury, departments must use memorandum accounts to record the accumulated balance of surpluses and deficits incurred in the provision of third-party fully cost-recovered outputs.

Memorandum accounts are to be used where:

- the outputs are provided by the department (including any boards, authorities or other organisations that, for appropriation and reporting purposes, legally form part of the department);
- third parties are to be charged for services provided on that basis; and
- refunding surpluses or levying for shortfalls through a contractual arrangement is costly or impractical.

Memorandum accounts are not to be used where:

- revenue is legitimately earned at market rates;
- revenue is received in advance as defined under generally accepted accounting practice;
- revenue results from internal charging within a department; or
- outputs where Government policy is explicitly to recover at less than full cost of the outputs.

The use of memorandum accounts does not affect the responsibilities of chief executives to manage expenses consistently with appropriations.

The structure and opening balance of each memorandum account is to be approved by the Minister of Finance and the relevant Vote Minister and Responsible Minister (if different).

Judgment is required in deciding whether it is acceptable to aggregate separate fees or different fee paying groups into a single memorandum account. Departments should consider the interests of fee-payers, compliance costs and the materiality of the amounts.

The memorandum account commences with an opening balance and is adjusted each year by the end-of-year surplus or deficit in relation to the fees covered by the memorandum account.

Where the accumulated positive balance of a memorandum account is greater than the year's deficit, the Minister of Finance, Vote Minister and Responsible Minister may jointly approve such capital contributions, subject to the economic effects of reductions in the accumulated balances being minimal (CAB (00) M 42/11 refers). Requests for capital contributions in these situations should be accompanied by the following information:

- the amount sought;
- the current balance of the memorandum account;
- an explanation of the cause of the deficit; and
- an assessment of the need to adjust fee levels.

Where the accumulated balance of a memorandum account is negative or less than the deficit incurred, normal capital contributions apply (CO (00) 12 refers).

Memorandum accounts must be presented in the information supporting the Estimates of Appropriations and annual reports. This disclosure should include a summary of movements in each memorandum account showing revenues and expenses separately, opening and closing accumulated balances and comparative information.

6.4 Crown revenue, expenditure, assets and liabilities

6.4.1 Definition of Crown

In this section of the Treasury Instructions the term "Crown" is used where revenue, expenditure, assets or liabilities are being managed by a department of the Crown otherwise than for departmental purposes. Such items are also referred to as "non-departmental".

Examples of "Crown revenue" and "Crown expenditure" are taxation revenue and benefit payments. Such revenue and expenditure can be distinguished from departmental revenue or expenditure that relate to, or result from, the supply of outputs by the department.

Similarly, "Crown assets" are those assets that the department manages for the Crown, rather than those assets used by a department for its own purposes. Crown liabilities are those liabilities that a department manages for the Crown, rather than liabilities incurred by the department as part of its normal operating activities. Crown assets and liabilities are not reported in the statement of financial position of the department.

6.4.2 Authority to operate Crown bank accounts

Under section 65S of the Act, the Treasury is responsible for the opening, maintenance and operation of all Crown Bank Accounts.

Where it is appropriate, the Treasury will establish Crown Bank Accounts for use by departments. Departments will be issued with a Notice of Delegation Regarding Crown Bank Accounts to operate these accounts, in accordance with section 65S of the Act (refer also to section 6.5 of the Treasury Instructions, "Banking").

6.4.3 Collection of Crown revenue

Departments collecting revenue for the Crown must:

- **bank all such revenue into a Crown Bank Account approved by the Treasury for that purpose;**
- **operate that Crown Bank Account in accordance with the terms of these Treasury Instructions, and any Notice of Delegation Regarding Crown Bank Accounts issued by the Treasury;**
- **maintain a management, accounting and information system which will:**
  - **recognise Crown revenue when it is earned;**
  - **account for all Crown debtors; and**
  - **account for all receipts relating to Crown revenue;**
- **operate an adequate system of internal control in respect of such debtors and revenue;**
- **ensure adequate procedures are adopted for the collection of these debts;**
- **provide forecasts to the Treasury of Crown revenue and the consequential cash flows; and**
- **provide such other information in relation to Crown revenue as the Treasury may from time to time require.**

If a remittance is received, which does not constitute full payment, and there are elements of both departmental and Crown revenue, then the money is to be applied to discharge the debt to the Crown first. Where such a remittance includes trust money and cannot be separated from departmental or Crown money, then the ranking of distribution should be approved by the Treasury.

6.4.4 Disbursement of Crown expenditure

Departments making payments for the Crown (including refunds of Crown revenue) to entities that are not included in the consolidated Financial Statements of the Government must:

- **make such payments from a Crown Bank Account approved by the Treasury for that purpose;**
- **only make such payments directly to the recipient (i.e. not to an agent for subsequent payment to the recipient) unless agreed by the Treasury;**
- **operate that Crown Bank Account in accordance with the terms of section 6.5 of the Treasury Instructions ("Banking"), any Notice of Delegation Regarding Crown Bank Accounts issued by the Treasury and the most recent Cabinet Office Circular on delegations for expenditure;**

- **maintain a management, accounting and information system which will:**
  - **recognise the expenditure when it is incurred;**
  - **account for all Crown creditors; and**
  - **account for all payments made on behalf of the Crown;**
- **operate an adequate system of internal control in respect of such creditors and payments;**
- **provide forecasts to the Treasury of the Crown expenditure and the consequent cash flows; and**
- **provide such other information in relation to Crown expenditure as the Treasury may from time to time require.**

In considering requests to use an agent for making payments to the recipient, the criteria the Treasury will consider include:

- Cost/benefit analysis demonstrating that the use of an agent is less costly than payments being made directly by the department.
- How the Crown can be assured that the correct recipients are correctly paid. Such assurance mechanisms will vary but should include evidence of processing controls.
- Reconciliations, reporting and management oversight and appropriate recovery procedures from the agent in case of error.
- Additional credit risk as a result of the use of an agent.
- Loss of benefit of the use of money in any period between money being disbursed to the agent and the recipient accepting the money.

The last two criteria may be able to be met through establishing funding arrangements that clear the agency account daily, rather than by providing a float for the agent.

Note that this instruction does not cover payments by departments to Crown entities, for example when the Crown entity is acting as a Crown agent in disbursing grants.

6.4.5 Management of Crown assets

6.4.5.1 General requirements

Departments managing assets for the Crown must:

- **maintain a management, accounting and information system which will account for all Crown assets managed by the department;**
- **value, or arrange for valuations of, Crown assets in accordance with the "Crown accounting policies for external financial reporting" (section 3 of the Treasury Instructions);**
- **apply appropriate asset management standards;**

- **operate an adequate system of internal control, including an appropriately detailed asset register (including revaluations); and**

- **provide the Treasury with such information as it may from time to time require.**

6.4.5.2 Delegation of authority to write off Crown assets

Where no statutory authority otherwise exists, departments may seek delegated authority to write off Crown assets when the following conditions are met:

- a documented set of policies and procedures (including appropriate approvals) is in place to ensure that a Crown asset will only be written off when all avenues of recovery have been exhausted or the expected costs of recovery outweigh the expected return from pursuing the debt or realising the asset. The expected return is to take into account the probability of a successful collection or sale and the amount involved;

- a half-yearly system of reporting on any write-offs to joint Ministers has been instituted. The report should include the nature of the assets, amounts involved, recovery actions taken, and cost-benefit analyses on pursuing the debts further;

- a follow-up action plan is established to survey any developments of debts written off, and resume recovery actions if new information suggests that collection is feasible; and

- joint Ministers are satisfied, on the recommendations of officials, with the procedures in place and support the delegations request.

The levels of delegation should be proposed by departments and agreed by joint Ministers on a case-by-case basis, taking into account the nature of the assets, the department's operations and the recommendations of the department and Treasury.

6.4.6 Management of Crown liabilities

Departments managing liabilities for the Crown must:

- **maintain a management, accounting and information system which will account for all Crown liabilities managed by the department;**

- **value Crown liabilities in accordance with the "Crown accounting policies for external financial reporting" (Section 3 of the Treasury Instructions);**

- **operate an adequate system of internal control; and**

- **provide the Treasury with such information as it may from time to time require.**

6.4.7 Provision of information to Treasury

The Treasury is responsible for the preparation of the “Government reporting entity’s” Financial Statements under section 27 of the Act. Section 2(1) of the Act defines “Government reporting entity” to mean the Sovereign in right of New Zealand and the legislative, executive and judicial branches of the Government of New Zealand. It therefore requires regular information from departments regarding Crown revenue, expenditure, assets, liabilities and cash flows. This may include information each month calculated on a cash basis and both cash and accrual information for half and full year external reporting. Section 79 of the Act gives Treasury the statutory base to request other information from departments.

6.4.8 Public Private Partnerships

Departments contemplating Public Private Partnerships must contact the Treasury's National Infrastructure Unit.

6.5 Banking

6.5.1 Introduction

This section of the Treasury Instructions relates to banking arrangements in respect of public money held in departmental and Crown bank accounts (both domestic and foreign currency). Refer to section 6.6 of the Treasury Instructions ("Trust money") for banking arrangements in relation to trust money.

Proper accounting systems must be set up and maintained to ensure that public money is properly accounted for and internal controls maintained.

6.5.2 Bank accounts

The Crown has contracted with Westpac Banking Corporation to provide the Crown's domestic banking operations. **All New Zealand dollar accounts must be set up at the Government Branch of Westpac Banking Corporation unless an exemption has been granted.** For Crown bank accounts an exemption is granted by the Minister under section 65R(1) of the Act. For departmental bank accounts the Treasury or the Minister, under section 65S(1) of the Act, grants an exemption.

Foreign currency bank accounts and non-Westpac New Zealand dollar bank accounts may be opened under the terms of a Direction for Foreign Currency Departmental Bank Accounts and a Notice of Delegation Regarding Crown Bank Accounts issued by the Treasury. With respect to Crown bank accounts, foreign currency accounts may be opened in accordance with the Notice of Delegation Regarding Crown Bank Accounts issued by the Treasury.

Departmental bank accounts are primarily the responsibility of departments. All Crown bank accounts are the responsibility of the Treasury (see the Treasury Instructions, section 6.4.2 "Authority to operate Crown bank accounts"). Crown and departmental bank accounts operate under the authority of the sections in Part 6 of the Act.

All payments (whether by cheque, tape, electronic funds transfer etc) out of a bank account are to be authorised by two account signatories, unless the Treasury approves a specific exemption. Appointment of account signatories (who may be specified officers or classes of officers), and changes thereto, are managed by the department under a direction by the Treasury.

Cheques drawn on a departmental bank account or a Crown bank account must have the name of the department printed on them.

Section 65U(4) provides that where money has been paid into a Crown or departmental bank account in error, or in excess of the amount required for the purpose for which it was paid, it may be paid out of that bank account to the person entitled to the payment. This section could be applied to refund payments, where the refund arises due to overpayment. Note that such refunds are not expenses and therefore do not require an appropriation; they should be accounted as reductions in revenue.

6.5.3 Departmental bank accounts

Treasury's prior approval must be obtained before opening or closing Departmental bank accounts (including sub-accounts). In the case of foreign currency departmental bank accounts the Treasury will issue Directions for Foreign Currency Departmental Bank Accounts, pursuant to section 65T of the Act, governing the terms and conditions under which such accounts must operate.

A positive balance must be maintained in New Zealand dollar departmental bank accounts at all times. Sub-accounts may go into overdraft provided the net position remains positive. Foreign currency bank accounts must not be overdrawn. Trust bank accounts must be managed under section 6.6 of the Treasury Instructions ("Trust money").

Departmental receipts and payments are paid into, and out of, departmental bank accounts. When establishing the account structure consideration should be given to cash forecasting requirements, cost of maintenance, size and nature of business, discounting facilities offered, volume of transactions and organisation structure. The bank account structure must be agreed with the Treasury.

The combined balance of departmental bank accounts operated by a department must never be overdrawn. Any cash balances held in New Zealand dollar departmental bank accounts at the Government branch of Westpac must be invested by the Treasury overnight. Departments may receive, on a periodic basis, payment from the Treasury for overnight cash balances held in departmental bank accounts.

No foreign currency bank account must be overdrawn at any time. Departments that earn interest on foreign currency departmental bank accounts must comply with the Direction for Foreign Currency Departmental Bank Accounts issued to it.

6.5.4 New Zealand dollar Crown bank accounts

Section 65U of the Act requires all receipts of public money to be paid into a Crown bank account or a departmental bank account. Departmental revenue is earned whenever a direct exchange relationship with a department occurs (i.e. when a department provides a good, service, right or money, for which it receives some form of payment or a right to payment). Departments also act for the Crown in respect of non-departmental activities and may therefore collect receipts for the Crown in respect of non-departmental revenue. Examples of such receipts are taxes, fines, duties, levies, royalties and infringement fees. **Departments must deposit all receipts from Crown activities into a “Crown receipts bank account”.**

Although the responsibility to operate Crown bank accounts rests with the Treasury, some Crown bank accounts will be able to be operated by departments. **The authority to operate Crown bank accounts results from the issuing of a formal Notice of Delegation Regarding Crown Bank Accounts by the Treasury in accordance with section 65S of the Act and section 41 of the State Sector Act 1988. Departments must at all times comply with the terms of any such Notice.**

Separate bank accounts will be established for depositing Crown receipts and making payments on behalf of the Crown. This separation ensures the integrity of the Controller function and Parliamentary supply, as amounts received will not be able to be directly used for payments, but will instead be remitted to the New Zealand Debt Management Office.

A positive balance must be maintained in each Crown bank account (or sub-account) operated by a department at all times unless the Notice of Delegation Regarding Crown Bank Accounts permits otherwise.

Departments must not undertake transfers between Crown accounts. If a transfer is necessary then the department must notify the Treasury of the need for the transfer, and the Treasury will arrange the transfer.

Crown bank accounts must be reconciled at least monthly.

At the end of the financial year any money remaining in a Crown bank account managed by a department must be returned to the main Crown bank account managed by the New Zealand Debt Management Office. Sufficient funds must remain in the Crown bank account to cover any unpresented cheques or other known withdrawals relating to the financial year just completed. Sufficient funds must also remain in the Crown bank account to enable the payment of any outstanding obligations that are to be met from that account.

6.5.5 Foreign currency Crown bank accounts

Foreign currency Crown bank accounts may only be opened pursuant to a Notice of Delegation Regarding Crown Bank Accounts and at banks listed in the department's policy document on the Management of Foreign Currency Transaction Exposure.

6.5.6 Foreign currency holdings in departmental and Crown bank accounts

Departments must hold no more foreign currency than is required for normal business operations. Approval to open a foreign currency departmental or Crown bank account should not be sought unless such an account is essential to the efficient conduct of that business.

6.5.7 Power of Minister or the Treasury in relation to Crown or departmental bank accounts

All directions issued by the Treasury or the Minister of Finance regarding:

- **the terms and conditions under which a bank account may be operated;**
- **the provision of information; and**
- **directions regarding public money including transfers from a departmental bank account**

must be adhered to promptly.

Each department has full responsibility for the operation of its departmental bank account, subject to direction from the Minister or the Treasury under section 65S of the Act. The powers conferred by sections 65S(3) and 65T(2) of the Act will be used only in special circumstances.

6.5.8 Cash payment schedule

Departments must negotiate a cash payment schedule with the Treasury prior to the commencement of each financial year. Cash is requested to be paid into either Crown payment bank accounts controlled by the department (non-departmental operations on

behalf of the Crown) or into departmental bank accounts. A separate cash payment schedule is required in respect of each Crown payment bank account operated by the department. Only one cash payment profile is required for departmental bank accounts.

Departments, as part of their budgeting process, must estimate the cashflows of the department's operations and any Crown activity managed by the department. This figure is then used to determine the total cash requirement for the year. This cash requirement is broken down into disbursements to be made at regular intervals (usually fortnightly) by the Crown. The cash payment schedule is arrived at through departmental negotiation with the Treasury Vote Analyst and is entered into the Crown's Financial Information System (CFISnet) via the cash module. Cash is disbursed in New Zealand dollars.

Any subsequent changes to the cash payment schedules must also be agreed with the Vote Analyst. Notice of any changes (i.e. a new cash payment schedule signed by both the department and the Vote Analyst) is required at least two full working days prior to the payment date.

Departments are responsible for transferring funds required for the normal course of business to departmental and Crown foreign currency bank accounts, subject to an agreed Departmental Foreign Exchange Exposure Management Policy and Notice of Delegation Regarding Crown Bank Accounts or Direction for Foreign Currency Departmental Bank Accounts.

Departments are required to reconcile cash requests back to appropriations to ensure that cash requests do not exceed authorised levels. Any reconciling items should be explained in the cash reconciliation within the CFISnet cash module.

6.5.9 Investment of public money

Departments are not permitted to invest cash balances. To minimise the cost of managing the core Government's cash flows it is essential to manage centrally not only the Government's cash disbursements (and the funding thereof) but also its investment activity. Investing in this context is investing by departments with entities other than the Crown (i.e. other than the "core" Crown). Section 65I of the Act confers investment powers upon the Treasury. These powers may not be delegated to departments. However, the Treasury may allow departments to open foreign currency interest bearing departmental or Crown bank accounts.

6.6 Trust money

6.6.1 Legislative provisions

Trust money is defined by section 66 of the Act as:

- Money that is deposited with the Crown pending the completion of a transaction or dispute and which may become repayable to the depositor or payable to the Crown or any other person.
- All money that is paid into Court for possible repayment to the payee or a third party, by virtue of any Act, rule or authority whatsoever.
- All money that is paid to the Crown in trust for any purpose.

- Money that belongs to or is due to any person and is collected by the Crown pursuant to any agreement between the Crown and that person.

- Unclaimed money that is due to or belongs to any person and is deposited with the Crown.

Trust money exists only where there is a trustee/beneficiary relationship. Money set aside by the Crown or department for a particular purpose will normally not be trust money as there is no directly identifiable beneficiary who has deposited the money with the Crown.

Trust money held by the Crown is to be managed separately from public money.

Any money held by a department which is not trust money is public money.

Under the Act, the Treasury has the responsibility to manage and invest trust money. The Treasury may appoint agents (including departments) to act on its behalf. Written Notices of Appointment to Manage and Invest Trust Money are issued in these cases.

Section 68 of the Act establishes the constraints on the investment of trust money.

6.6.2 Notice of appointment

A written Notice of Appointment to Manage and Invest Trust Money, in accordance with sections 66(4) and 67(3) of the Act, specifying the terms of the appointment to administer trust money, will be issued by Treasury to departments acting as trust money agents. Only those departments holding such a Notice are authorised to manage and invest trust money and operate trust bank accounts.

Departments must not establish or create trusts. Departmental monies may be deposited into a trust bank account only if the following conditions have been met:

- **the department is purchasing services from the trust; or**

- **the department is not the sole beneficiary.**

6.6.3 Accounting for trust money

Where a department is acting for the Crown as manager of trust money, the department must manage and account for trust money separately from public money. Trust money must be banked into a separate bank account for each trust.

In accounting for trust money, departments are responsible for maintaining documentary evidence of contributions, distributions, revenue and expenses for each beneficiary.

6.6.4 Internal control and trust money

Under the Notice of Appointment to Manage and Invest Trust Money, the Chief Executive of a department must ensure that the appropriate internal control systems are in place in respect of trust money managed by the department.

Internal controls in respect of trust money include the following:

- **keeping detailed records of all outstanding money held in trust;**

- **controlling receipting procedures and ensuring proper authorisation of payments;**
- **monthly balancing of the trust bank account and investments to the department's accounting records;**
- **adequate security and control over the blank cheque forms; and**
- **adequate security over receipt books.**

6.6.5 Reporting of trust money

Departments must provide reports to the Treasury, in the form specified, detailing receipts, payments and balances of trust money managed by the department. These reports must be made at year-end for inclusion in the financial statements of the Government of New Zealand, and at such other times as the Treasury may from time to time request.

6.6.6 Records of trust money

The department is responsible for maintaining records of the deposit. The records must include the current (and any preceding) Notices of Appointment to Manage and Invest Trust Money and show the following in respect of each category of trust money specified in the Schedule to the Notice of Appointment:

- **documentation supporting existence of trust relationship (i.e. contracts, letters of agreement/appointment, legislation, trust deed, etc);**
- **name of depositor(s);**
- **name of beneficiary(ies);**
- **date of deposit;**
- **bank where deposit is held;**
- **amount of the deposit;**
- **interest terms;**
- **treatment of interest payments;**
- **maturity date;**
- **date deposit is to be refunded;**
- **date and amount of interest refund(s); and**
- **date and authority releasing the deposit from the trust account.**

6.6.7 Trust bank accounts

Departments appointed to manage trust money must operate a separate bank account for each trust. The Notice of Appointment to Manage and Invest Trust Money will contain authority to establish the bank account(s). These accounts will be separate from departmental bank accounts or Crown bank accounts.

Trust money must be banked into a trust bank account(s), and may be invested only in accordance with the Notice of Appointment. Payments may not be made from trust bank accounts until the money representing the payment has been credited to the account. Trust bank accounts must not be overdrawn.

Unclaimed trust money is deemed to be public money and must be credited to a Crown bank account. Full details of the payment of unclaimed trust money to a Crown bank account must be provided to the Treasury. Section 70(1) of the Act details the circumstances giving rise to unclaimed trust money. Subsequent claims on unclaimed trust money paid into a Crown bank account must be treated in accordance with section 70(2) of the Act.

6.6.8 Investment of trust money

A department which is delegated authority to invest trust money may invest only in accordance with the Notice of Appointment to Manage and Invest Trust Money. Where practicable, any interest earned on trust money must be either added to the original sum and accounted for by apportionment to each beneficiary, or distributed to each beneficiary. The Treasury must be consulted and concur with the method of treating interest when a department does not consider it practicable to treat interest as detailed above.

6.6.9 Taxation

Departments must ensure that they are aware of relevant taxation legislation to the extent that it affects trusts. The Inland Revenue Department should be consulted, or legal advice sought, as necessary.

6.6.10 Definition of terms

Contribution: Amount that has been contributed to the trust by donors during the reporting period and which has been banked to the Trust bank account.

Distribution: Sum paid to beneficiaries of the trust during the reporting period.

Expenses: These are only the direct costs paid by the trust in achieving its aims. This may include cash paid for taxation, administrative and accounting fees, salaries and wages of trust employees, purchase of goods and services and the purchase of items of property, plant and equipment.

Revenue: The amount of interest or other income received by the trust on trust investments, assets, and current balances.

6.7 Contingent liabilities

6.7.1 Introduction

When determining the accounting disclosures for contingent liabilities, the NZ IAS 37 definition is the relevant definition.

6.7.2 Contingent liability types

The major types of contingent liabilities that may arise in respect of non-departmental activities include guarantees, indemnities and warranties, performance bonds, legal disputes, uncalled capital on shares and other securities.

Departments should be aware that guarantees, indemnities and warranties might be couched in language that hides their nature. This would particularly apply where formal contracts do not exist. A guarantee may be given without the term "guarantee" ever being used. Similarly, the use of the term "guarantee" may not necessarily mean that a contingent liability arises (i.e. Guaranteed Retirement Income).

6.7.3 Register of contingent liabilities

Each Government Department must maintain a Register of Contingent Liabilities in which all contingent liabilities given on behalf of the Crown by, or in respect of, the department are to be recorded. The register must disclose the nature of the contingent liability and provide such details as the date that it was incurred, the authority under which it was given, its term, and the amount if it is able to be quantified.

The Chief Executive must determine the responsibility for the management of the Register of Contingent Liabilities. It is recommended that the Register be operated or monitored by the Chief Legal Adviser or where this does not exist, by the senior Corporate Services Manager. These personnel have the greatest knowledge of the contracts entered into by the Department and of any instances where the Department has bound the Crown to future possible expenditure.

6.7.4 Certification by Minister

At 31 December and 30 June, the details of current guarantees from each departmental register must be provided to the Responsible Minister of the Department for certification that they are unaware of any additional contingent liabilities that have been omitted. For Offices of Parliament the certification will be provided by the Chief Executive.

6.7.5 Power to give guarantees and indemnities

Subject to delegations or regulations, all guarantees and indemnities are required to be given or approved by the Minister of Finance. Under section 65ZD of the Act, the power to give guarantees and indemnities has been conferred upon the Minister of Finance. Under section 65ZE a department may give a guarantee or indemnity that is of a type specified in regulations, if it is necessary or expedient in the public interest to do so. The Public Finance (Departmental Guarantees and Indemnities) Regulations 2007 provide for the types of guarantees or indemnities that a department may given under s65ZE. See also Treasury Circular 2007/11.

Costs incurred under guarantees or indemnities that are authorised by regulations or given under delegated authority are to be met out of departments' baselines and are to be advised to the Secretary to the Treasury**.**

Where a contingent liability exceeding $10,000,000 is incurred under section 65ZD or 65ZE, a statement that the contingent liability has been incurred, containing such details relating to that guarantee or indemnity as the Minister considers appropriate, must be published in the Gazette and tabled in Parliament as soon as practicable.

Under section 63 of the Act the Minister of Finance may issue securities, in the manner and form he thinks fit, for any money borrowed by the Crown.