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# The Importance of Accounting to the Crown Balance Sheet

# Part 1: The International Story

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# Fra Luca Pacioli

## – The father of accounting

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# Expense or Asset?

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# WALL STREET CRASH!

## Black Thursday in America

Stocks Plunge and  
Eleven  
Centuries Shake

NEW YORK (AP) — The stock market crashed today, sending investors fleeing from Wall Street and shaking the confidence of investors worldwide.

Investors who already feared a recession were shaken by the crash, which sent the Dow Jones Industrial Average down more than 1,000 points.

In the minutes before the crash, the market had been trading in a state of confusion. Many investors were unsure of what to do, and the crash was a result of a combination of factors, including a report that the Federal Reserve had raised interest rates.

The crash was the worst in the history of the stock market, and it led to a period of economic hardship that lasted for several years. Many investors lost their savings, and the economy slowed down significantly.

By [illegible]

Investors who had been optimistic about the future of the economy were shaken by the crash. Many of them had been investing in stocks, and the crash led to a loss of confidence in the market. This led to a period of economic hardship that lasted for several years.



Investors who had been optimistic about the future of the economy were shaken by the crash.

## What Went Wrong?

# The first accounting principle?

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*Unrealised profit should not be credited to income account of the corporation either directly or indirectly, through the medium of charging such unrealised profits amounts which would ordinarily fall to be charged against income account. Profit is deemed to be realised when a sale in the ordinary course of business is effected, unless circumstances are such that the collection of the sale price is not reasonably assured. An exception to the general rule may be made (for industries in which trade custom is to take inventories at net selling prices, which may exceed cost).*

Audits of Corporate Accounts, 1934  
Special Committee on Co-Operation with Stock Exchanges

# Where's the framework?

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Allocate  
revenues and  
costs to period

Match Costs  
and Revenues

True and fair,  
but prudent

Remove  
distortions

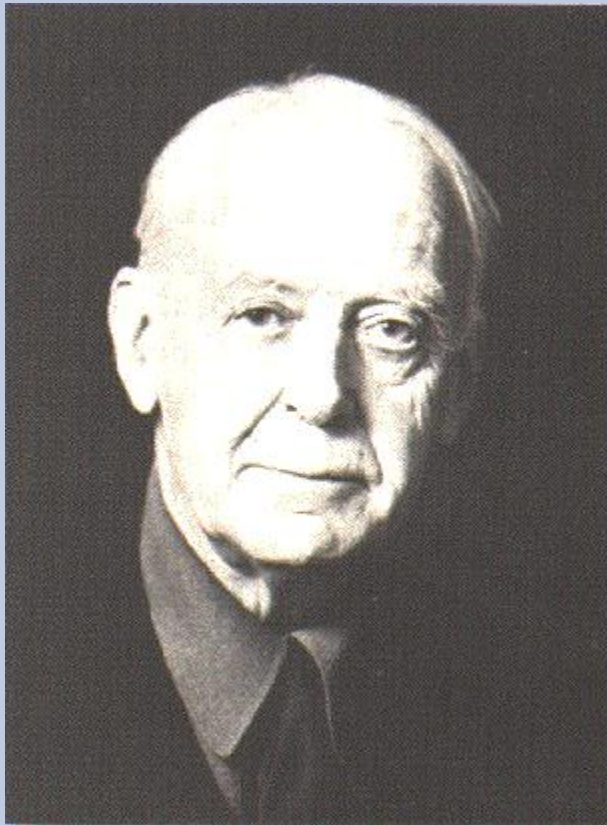
Avoid artificial  
fluctuations in  
net income

Codify practice,  
seek general  
acceptance



# A definition of income

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“the maximum amount which can be spent during [a period] if there is to be an expectation of maintaining intact the capital value of prospective receipts (in money terms)”

'the amount which a man can consume during a period and still remain as well off at the end of the period as he (thought he) was at the beginning'

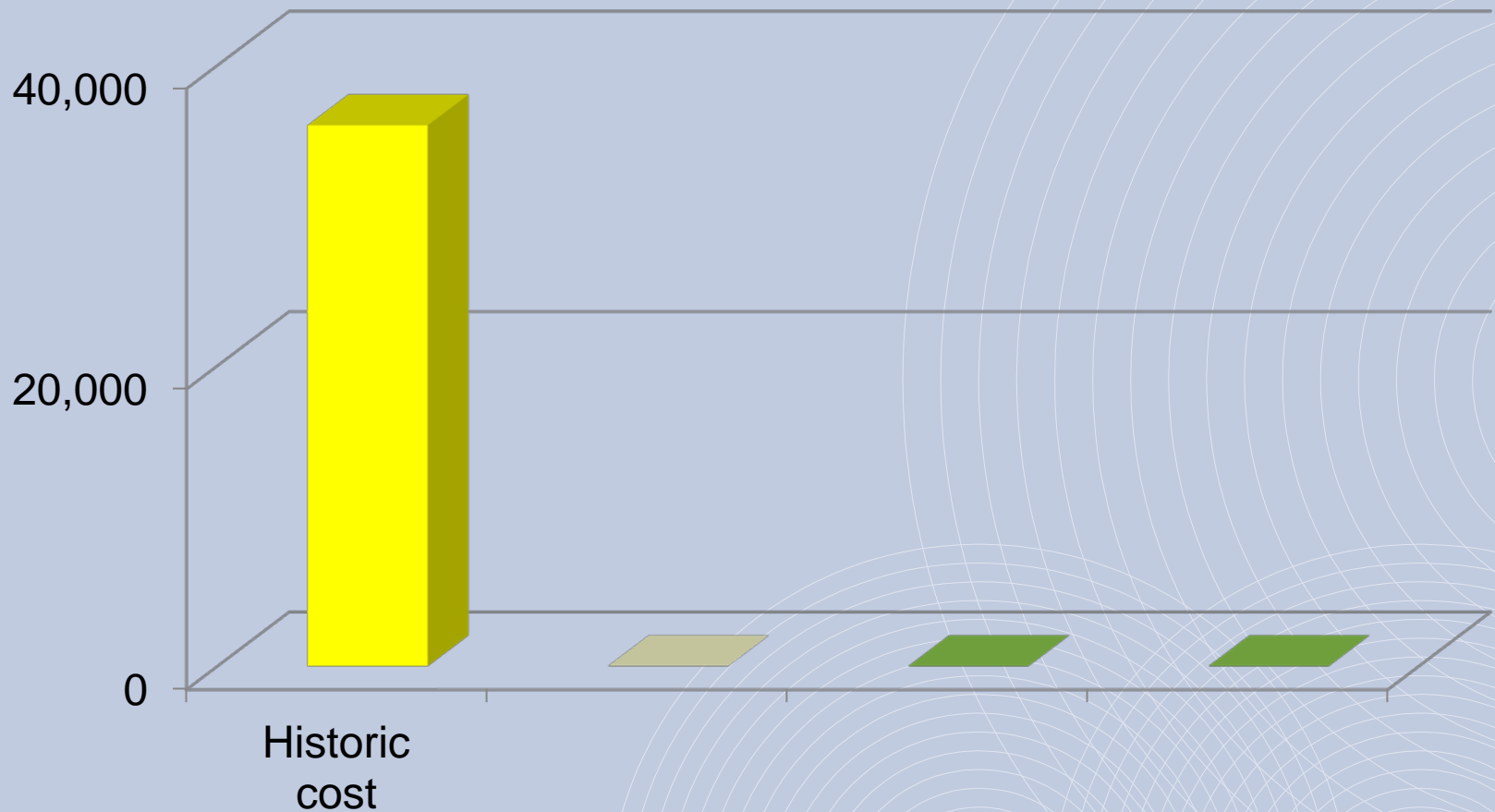
John Hicks (1946)



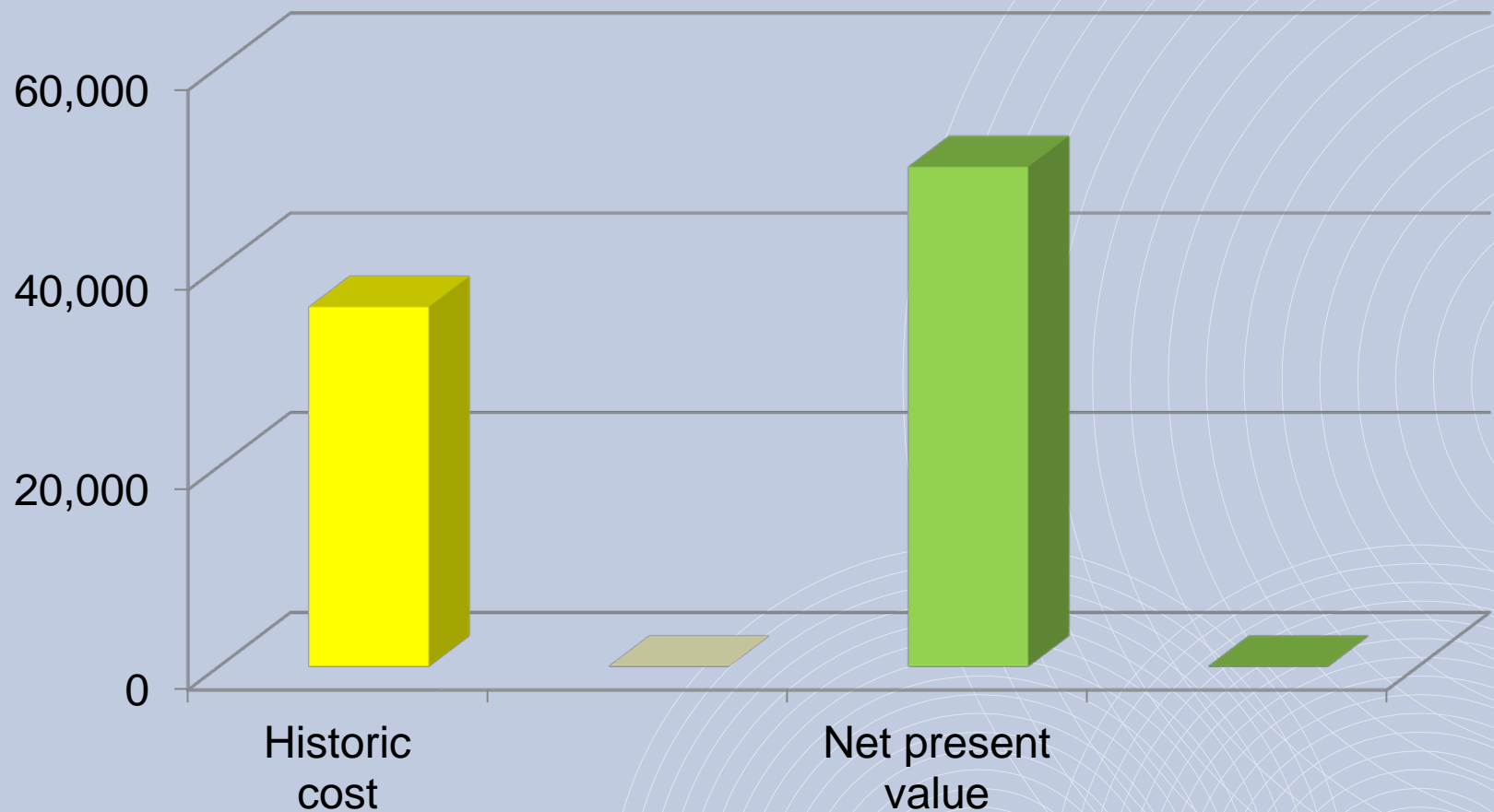
# The Conceptual Structure

The Accounting Equation	Definitional elements		
Assets	As a result of past events	Present resources	That will provide future economic benefits
Less Liabilities	As a result of past events	Present obligations	That will involve economic sacrifice
Equals Equity			
Movement in Equity in Period = Net Income in period			

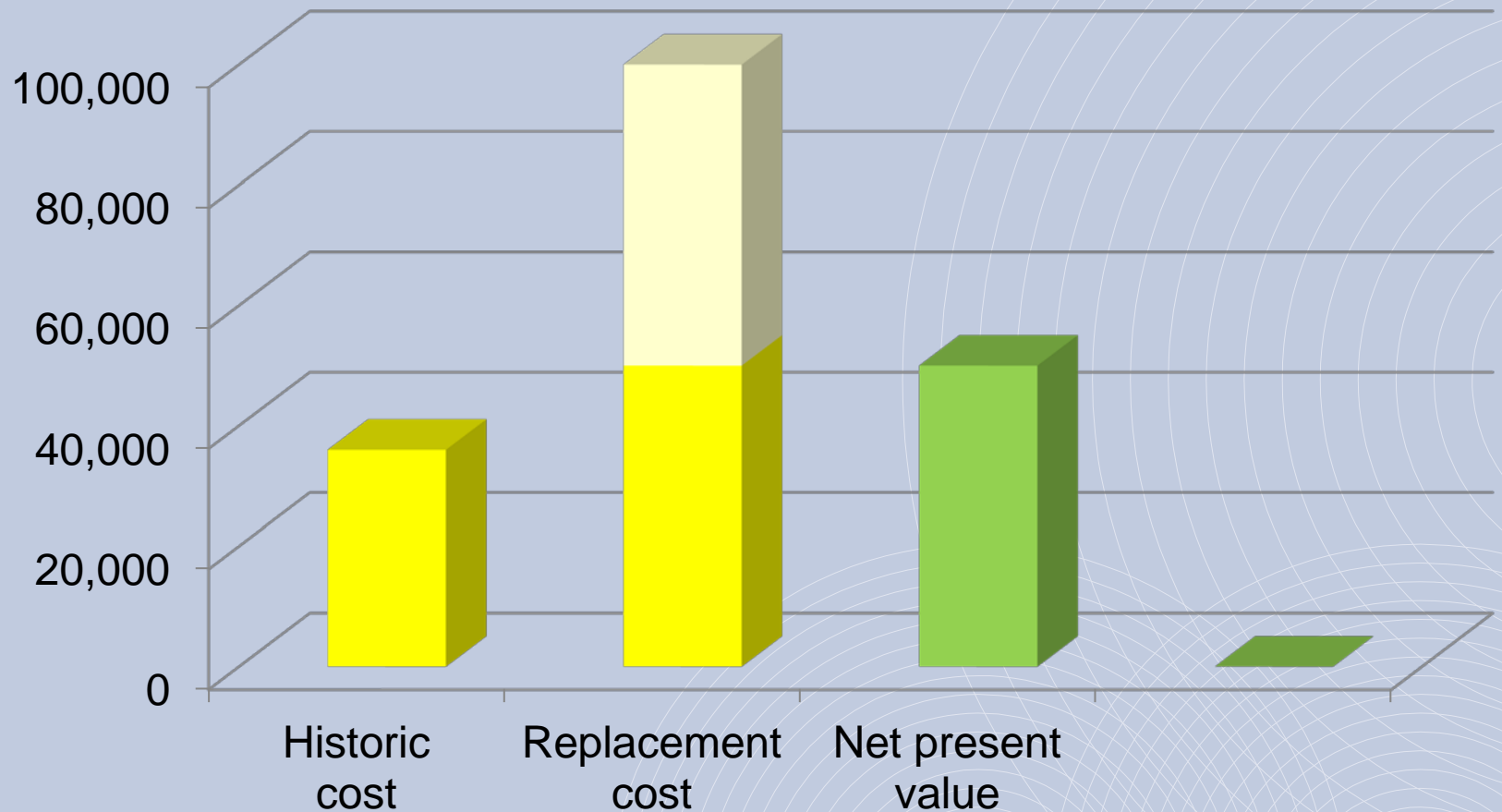
# Johnsonville School Classroom



# Johnsonville School Classroom

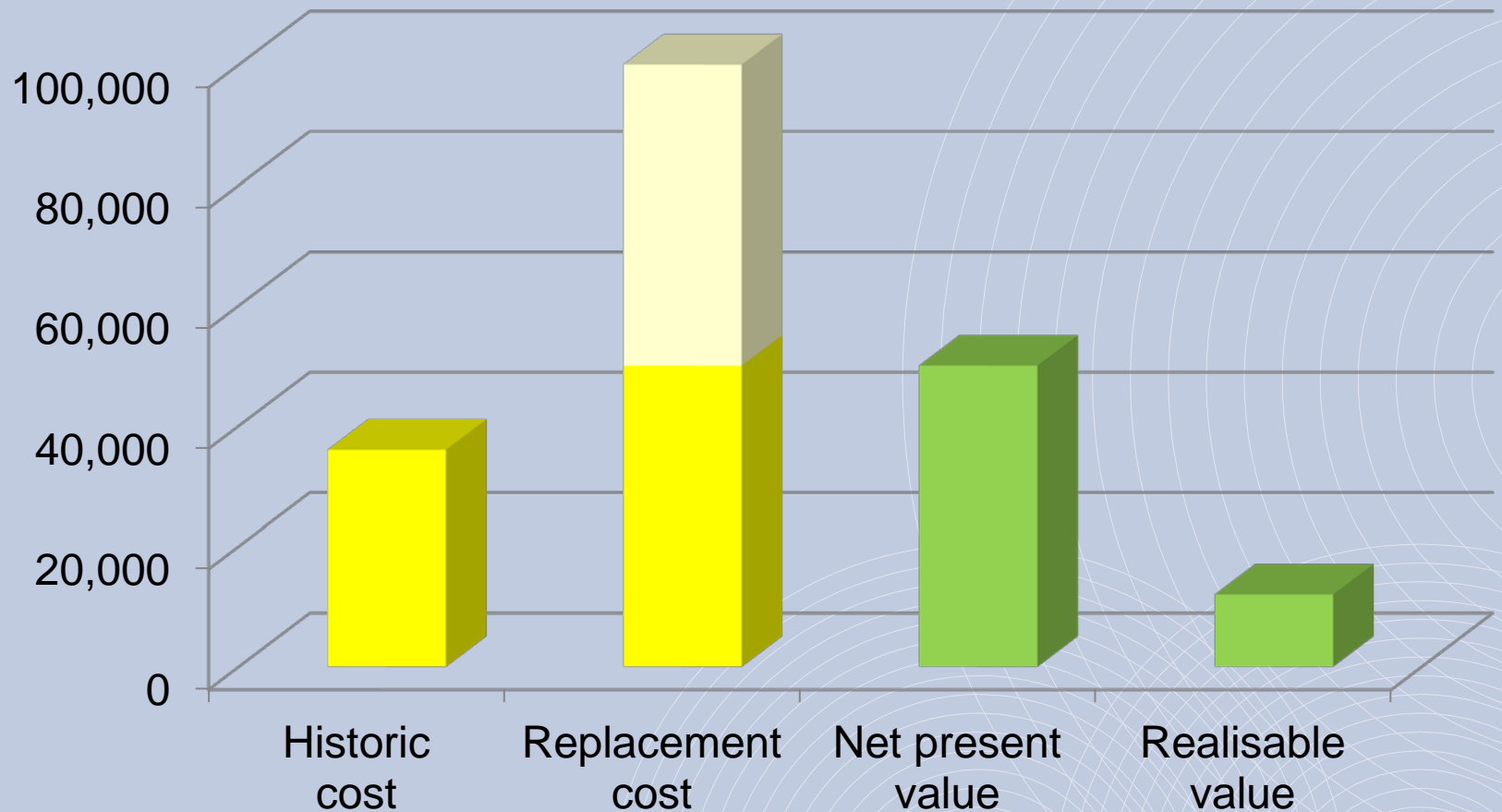


# Johnsonville School Classroom





# Johnsonville School Classroom



# Benefits of the Conceptual Framework

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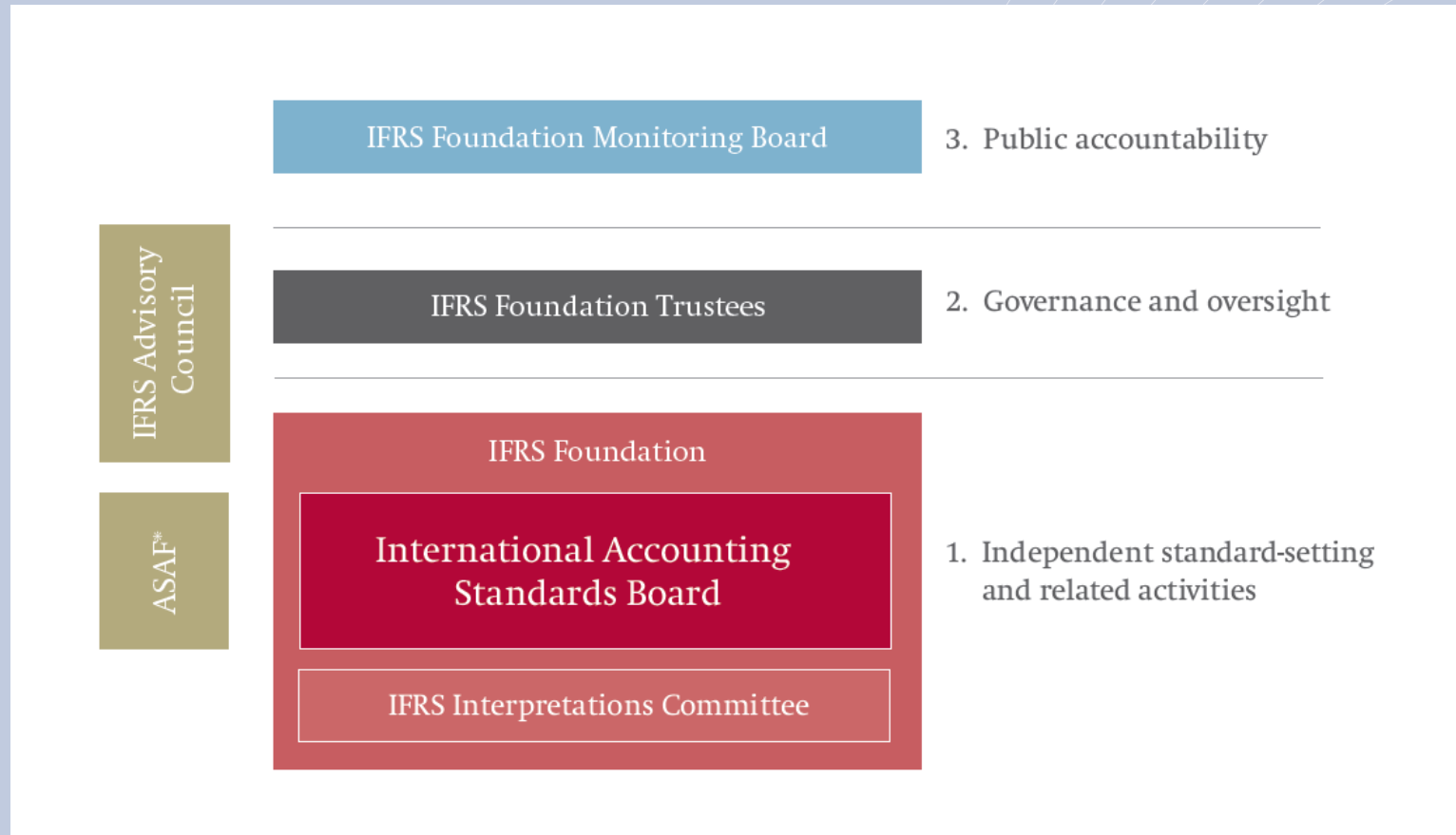
- Common frame of reference
- Discipline for consistency
- Less re-debate of issues
- Accountability
- Education
- Basis for gaps in GAAP

# The rise of the Global Capital Market

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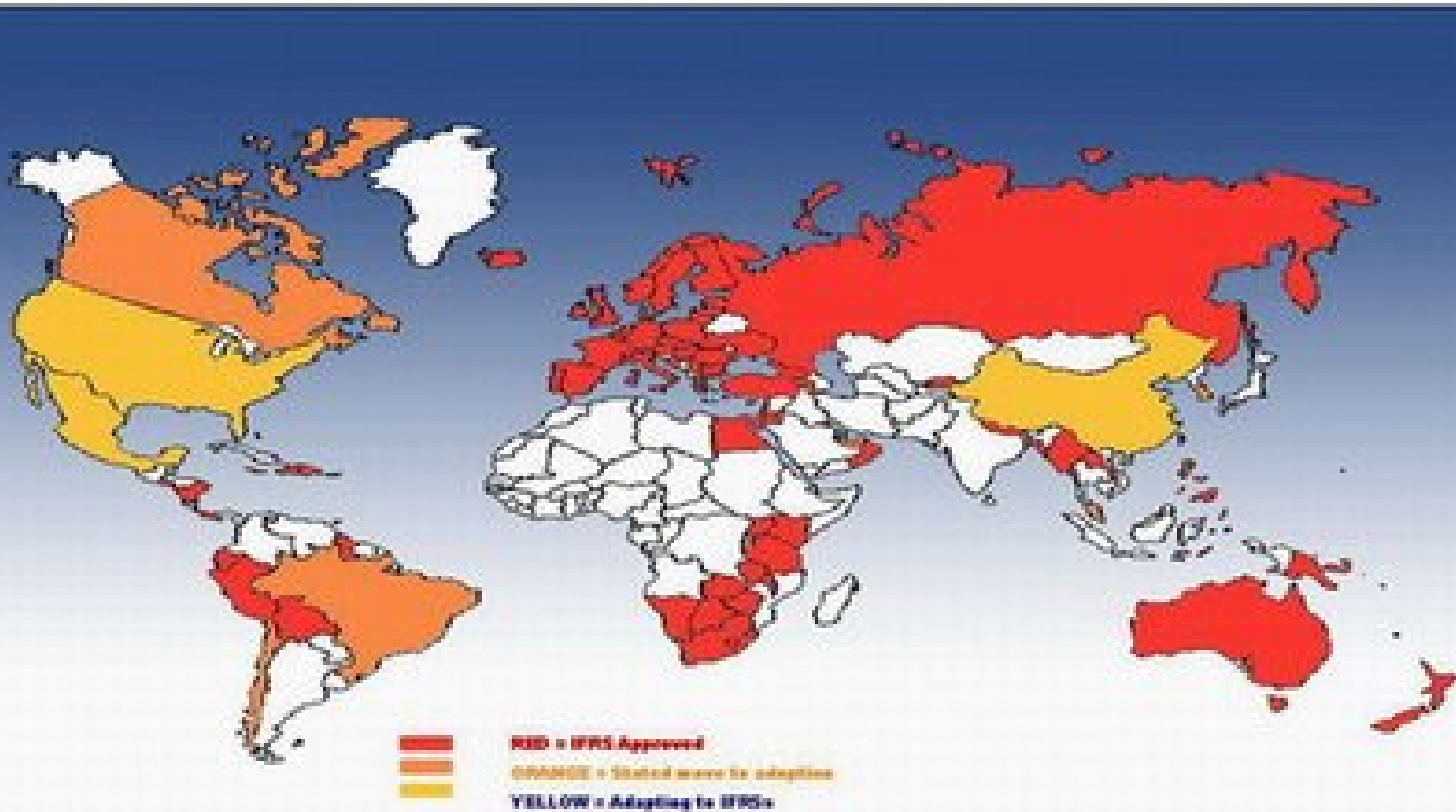


# 2001 : A new Structure





# IFRS AROUND THE WORLD



# Global Financial Crisis

IF YOU UNDERSTAND  
THE ACCOUNTING STANDARD  
FOR FINANCIAL INSTRUMENTS,  
THEN YOU HAVEN'T READ IT  
PROPERLY...

IAS 39

- Fair value hedge/cash flow hedge
- Held for trading/available for sales
- Derecognition
- Embedded derivatives



# International Public Sector Accounting Standards Board



# IPSASB v IASB – Sector Neutrality

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## Characteristics of the public sector

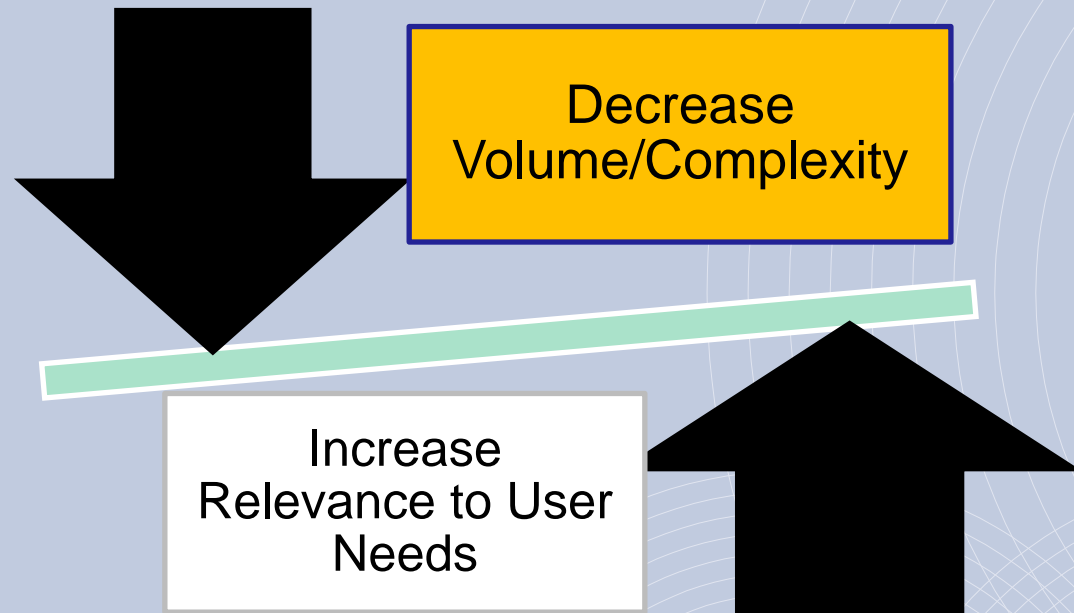
- Service delivery objective – broader information needs
- Involuntary Transfers and Non-Exchange Transactions
- Importance of the Approved Budget
- Nature and Purpose of Assets in the Public Sector
- Longevity of the Public Sector
- Regulatory Role of Public Sector Entities
- Importance of Statistical Bases of Accounting



# The current challenge

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- People are calling for:



# IASB Conceptual Framework Developments

## Items Included In OCI In the 'broad' approach

## Items Included In OCI In the 'narrow' approach

### Bridging items

### Mismatched remeasurements

### Transitory remeasurements

#### What distinguishes these items from those recognised in profit or loss?

The item of income or expense represents the difference between:

- (a) a measurement used in determining profit or loss; and
- (b) a remeasurement used in the statement of financial position.

The item of income or expense represents the effects of part of a linked set of assets, liabilities or past or planned transactions. It represents their effect so incompletely that, in the opinion of the IASB, the item provides little relevant information about the return that the entity has made on its economic resources in the period.

The item meets all the following criteria:

- (a) the asset or the liability has a long-term time horizon for realisation or settlement;
- (b) amounts recognised in OCI are likely to fully reverse or significantly change; and
- (c) use of OCI enhances the relevance and understandability of items in profit or loss.

#### When should items recognised in OCI be reclassified (recycled) into profit or loss?

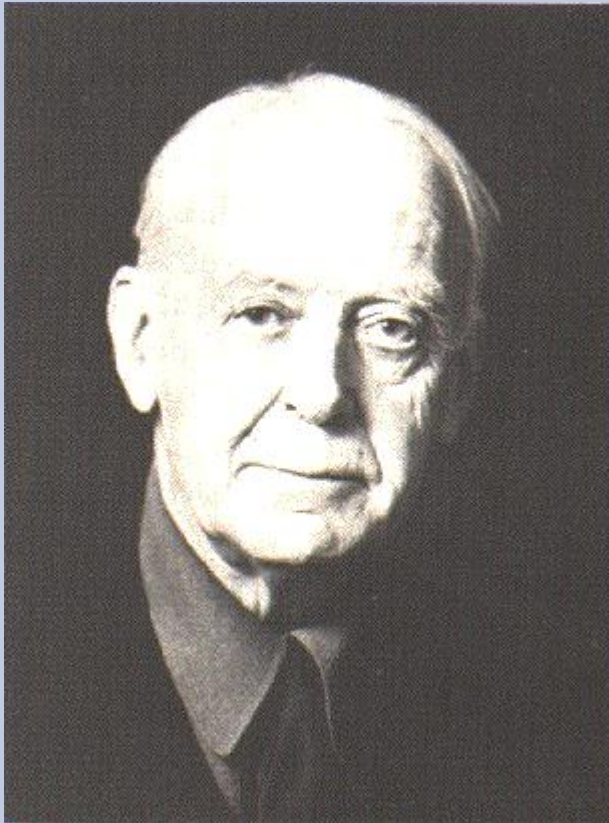
Recycle as a consequence of the measurement basis presented in profit or loss.

Recycle when the item can be presented with the matched item(s).

Recycle for some types of OCI items if and when it provides relevant information in profit or loss.

# IPSASB : Hicks on Income No. 2

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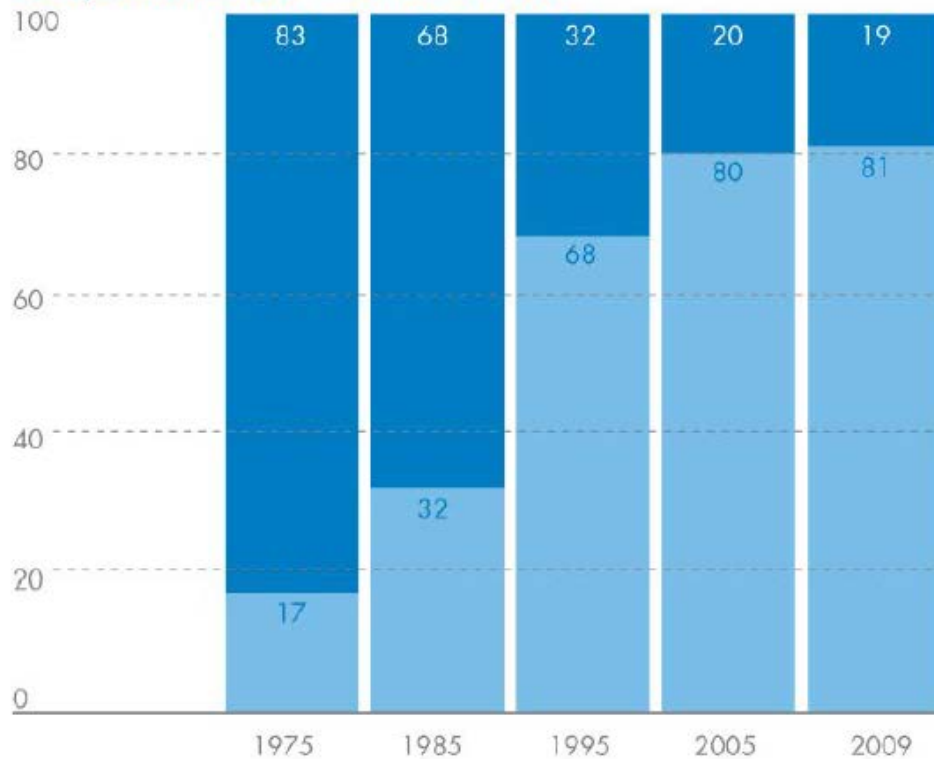
Hicks initial concept of income is fully determinable and objective only in the presence of complete and perfect markets (i.e., when every resource and claim on future cash flows has been commoditized into fully exchangeable assets and where everyone faces the same prices, including the discount rates)

A second definition of income:

The amount that an entity can consume in a period and still expect to be able to consume the same amount in each ensuing period

# Physical and financial assets a diminishing part of the story

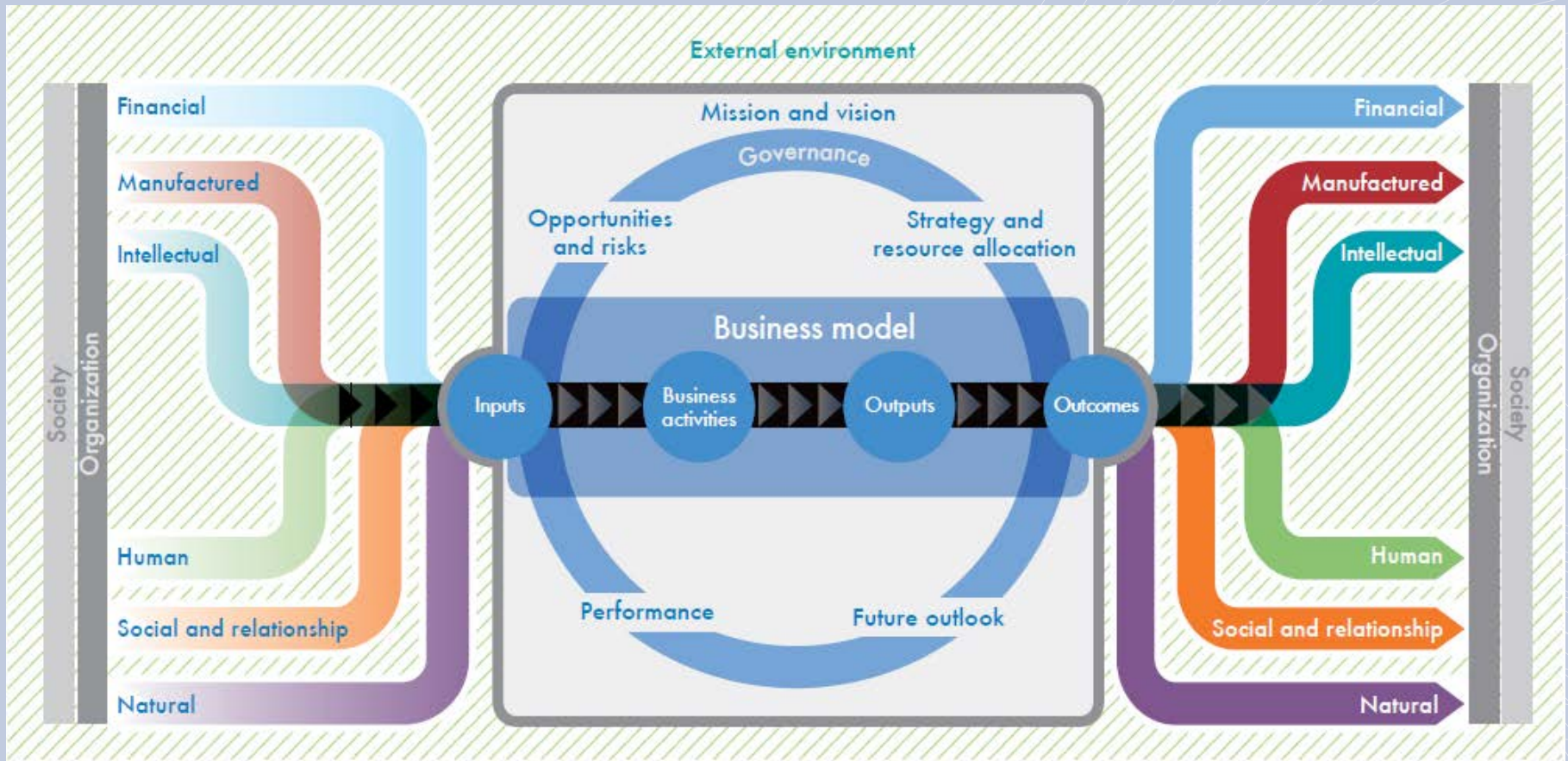
Components of S&P 500 market value



Physical and financial assets  
Other factors

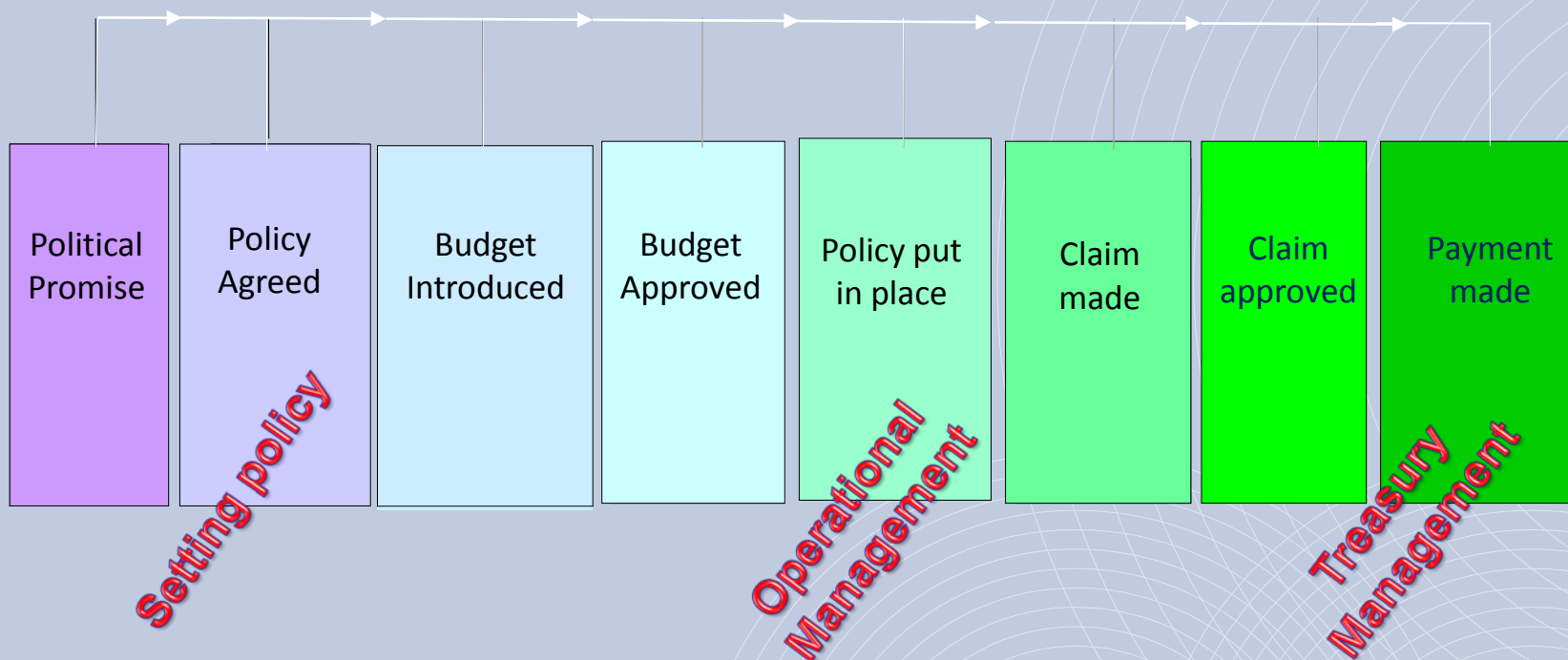


# Integrated Reporting on value creation



# Illustrating the implications for the Crown Balance Sheet

## Reporting on the development of social policy obligations



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# The Importance of Accounting to the Crown Balance Sheet

# Part 2: The New Zealand Story

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# 1970's

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# The PM was an accountant!

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# In the 1970's

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- Professional Standard Committee established to issue accounting standards -1973
- NZ joined the International Accounting Standards Committee (IASC) - 1974
- Creation of International Federation of Accountants (IFAC) -1977
- Accrual accounting evaluation begins in public sector
- Inflation (ie price level) accounting evaluation begins in private sector

# 1980s



# In the 1980's

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- NZ was one of only 9 countries around the world that actually "made" accounting standards from first principles
- Accounting standards did not have the force of law behind them, so there was no legal imperative to get things right
- Rogernomics followed by the 1987 crash drew attention to accountability
- Public Finance Act 1989
- Sector neutral accounting seemed appropriate

# 1990's

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# In the early 1990's

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- Finalisation of a "sector neutral" conceptual framework that gave equal weighting to "cash flows" and "service potential"
- Creation of Differential Reporting to recognise and solve the "cost/benefit" equation
- Financial Reporting Act 1993 providing a "one stop shop" for the accounting profession on accounting matters and creation of the ASRB
- Increasing influence of the International Accounting Standards Committee on NZ standard setting (particularly asset/liability recognition)

# In the late 1990's

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- The emergence of the G4+1 addressing conceptual framework matters so that International Accounting Standards (IAS) would be of better quality
- Heavy focus on defining "fair value" vs. "cost"
- On-going contribution to the IASC (Agriculture)
- First IPSASB standard issued (based on DNA found in the IASC standards - 1997)



# 2000's

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# In the early 2000's

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- Formation of the International Accounting Standards Board in London – a full time, well funded Board with supporting resources
- The dotcom crash followed by the demise of World Com, Tyco, Enron and Arthur Andersen
- Ian Ball's appointed as CEO of IFAC (International Federation of Accountants)
- Continued active ASRB support of the IPSASB

# Infrastructure investment and PPPs

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# During the mid 2000's

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- Accounting Standards Review Board decided to "adapt" IFRS so that NZ could continue to have sector neutral financial standards
- Challenge for the public sector was getting enough airplay time at the FRSB to consider public sector issues given then 2005 start date for IFRS for listed companies around the world (eg Europe and Australia)

# 2009



# Since 2009

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- Creation of the External Reporting Board (an independent Crown entity) with both an accounting and auditing mandate
- Private, but not public sector accounting alignment with Australia
- Auditor Regulation Act 2011 (does not cover the Office of the Auditor General)



# The future?

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# GIGGO

# Biggest accounting issues

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- Getting the cost/benefit equation correct
- Determination of fair value
- Impairment
- Social policy obligations (retirement)
- Likely divergence between IPSAS and IFRS
- Information overload ("excess baggage")

# So to recap: Why is accounting so important to the Crown Balance sheet?

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# Final comments and questions

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