THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Instructions 2018

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

July 2018

New Zealand Government

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The only official version of the Treasury Instructions appears on the Treasury's website at https://treasury.govt.nz/publications/instructions/treasury-instructions-2018

The Persistent URL is http://purl.oclc.org/nzt/g-ti. 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.

Contents

1 Introduction to Treasury Instructions

1.1 General

This document comprises:

(1) a summary 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 within this document were issued on 31 July 2018, and apply from 1 July 2018. All previous Treasury Instructions applying to departments as defined in the Act are hereby revoked.

1.3 Purpose of Treasury Instructions

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

- requiring information to be supplied to the 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 departments 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.

1.4 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 https://treasury.govt.nz.

1.5 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.

1.6 Access to Treasury Instructions

The current and only official version of the Treasury Instructions is on the Treasury's website (https://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.

1.7 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.

The Treasury Instructions may be updated during a financial year; it is the responsibility of every Chief Executive to ensure that the latest version is applied.

Treasury Circulars can also be issued during the year, refer to section 1.9 for the relationship between Treasury Circulars and Treasury Instructions.

1.8 Changes since last update

The last Treasury Instructions were issued on 31 July 2017. There have been some significant changes in the Financial Instruments section in this year's revised Treasury Instructions due to the early adoption of the new PBE IFRS 9 in the 2018/19 financial year for the Financial Statements of the Government of New Zealand. All amended sections are noted below. The other minor changes made in this update relate to the incorporation of additional guidance previously found in old Treasury circulars and the inclusion of links to other existing guidance where applicable. Where possible, Treasury circulars that are no longer relevant or whose guidance is now incorporated into these instructions have been withdrawn.

Section reference	Section name	Change
3.5.2	Basis of combination	Minor wording change.
3.5.9.3	Subsequent measurement	Minor wording change.
3.5.7	Financial Instruments	The accounting policy has been rewritten to reflect the requirements of PBE IFRS 9 which has been adopted for the first time in 2018/19.
4.3.3.1	Destroyed assets	Amendment to better reflect the description of current practice.
4.3.3.3	Repairing assets that have been impaired	Amendment to better reflect the description of current practice.
6.3.3	Other expenditure requiring Minister of Finance approval	Amendment to better reflect the description of current practice.
6.3.7	Memorandum accounts	Amendments to include additional guidance on use of memorandum accounts and their relationship to capital investments.
6.3.8	Management of departmental assets	Updated the Cabinet Office Circular reference regarding *Proposals with Financial Implications and Financial Authorities*.
6.5.8	Public Private Partnerships	Amendment to better reflect the description of current practice.

Section reference	Section name	Change
6.7.1	Legislative provisions	Amendment to better reflect the description of current practice.
6.7.7	Trust bank accounts	Amendment to better reflect the description of current practice.
6.7.8	Investment of trust money	Amendment to better reflect the description of current practice.
6.8.3	Register of contingent assets and liabilities	Amendment to better reflect the description of current practice.

1.9 Relationship between Treasury Instructions and Treasury Circulars

Treasury Instructions generally specify what the Chief Executive of a department of the Government 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 see https://treasury.govt.nz/publications/guidance/treasury-circulars

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, 45B and 45BA).

2.3 New Zealand generally accepted accounting practice

New Zealand generally accepted accounting practice (NZ GAAP) for the financial statements of the Government and its departments (including non-departmental activities) is defined by section 2 of the Act as having the same meaning as in section 8 of the Financial Reporting Act 2013. The Financial Reporting Act defines compliance with GAAP as compliance with applicable financial reporting standards and in relation to matters for which no provision is made in applicable financial reporting standards, an authoritative notice. An applicable financial reporting standard is one that has been issued by the External Reporting Board (XRB) that applies to the reporting entity and to the accounting period or the interim accounting period in accordance with the financial reporting standard.

The XRB issues accounting standards for public sector public benefit entities (PBE standards). A list of approved standards, and authoritative notices, including the framework for financial reporting in New Zealand, can be found on the XRB website (www.xrb.govt.nz).

PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* (paragraphs 12 to 15) 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. PBE IPSAS 3 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.

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 judgement in applying the requirements of PBE IPSAS 3, 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 *Public Benefit Entities' Framework* issued by the XRB *(PBE framework*). 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 (NZ GAAP) applicable to the public sector is largely comprised of PBE IPSASs with a small number of PBE IFRSs, PBE IASs and PBE FRSs. The Crown applied PBE standards for periods from 1 July 2014 in the forecast financial statements of the Government published in the 2014 Budget, and applied them in financial statements of the Government prepared for periods beginning on or after 1 July 2014. A copy of the PBE Framework can be found here - https://www.xrb.govt.nz/accounting-standards/archived-accounting-standards/nz-ifrs-pbe/new-zealand-framework-pbe/.

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.

Under current NZ GAAP, departmental financial statements must 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

(c) a statement that the financial statements have been prepared in accordance with NZ GAAP and that they comply with public sector PBE standards and have been prepared in accordance with either:[1]

- **Tier 1 *PBE standards***
- **Tier 2 *PBE standards and applied disclosure concessions, or***
- **Tier 3 *PBE Simple Format Reporting – Accrual (Public Sector).***

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[1] Tier 4 *PBE Simple Format Reporting – Cash (Public Sector)* is not applicable to departments.

The criteria under which a department is eligible to, and elects to report in accordance with Tier 2, Tier 3 or Tier 4 PBE standards are found in XRB A1 *Accounting Standards Framework.* XRB A1 is the XRB Board's overarching document that establishes:

a) the tiers of financial reporting for all entities that are required to report

b) the criteria for each tier of financial reporting

c) the accounting standards and authoritative notices that are applicable to each tier of financial reporting

d) the requirements for an entity to move from one tier of financial reporting to another tier of financial reporting, and

e) define what comprises generally accepted accounting practice and what comprises a "non-GAAP standard" issued by the External Reporting Board.

2.3.2 Objectives of general purpose financial reporting

The *PBE Framework* (paragraphs 12 to 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 accrual basis of accounting, and
- the "going concern" concept.

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) (*PBE Framework* paragraph 23).

PBE IPSAS 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, PBE IPSAS 14 *Events after the Reporting Date* should be used in determining the appropriate disclosures. If the going concern assumption is no longer appropriate PBE IPSAS 14 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 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 *PBE Framework,* PBE IPSAS 1 and EG A7 *Explanatory Guide: Materiality for Public Benefit Entities*.

The *PBE 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)
- Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement.

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.

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

- Members of Parliament
- Ministers
- The 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.

2.4 Accounting policies

The notes to general purpose financial statements must include a summary of significant accounting policies (PBE IPSAS 1 paragraph 132). This summary must include:

- **the measurement basis (or bases) used in preparing the financial statements, and**
- **the extent to which the entity has applied any transitional provisions in any PBE standard, and**
- **the other accounting policies used that are relevant to an understanding of the financial statements.**

PBE IPSAS 3 specifies the disclosures required as a result of changes in accounting policies.

An entity must also disclose the judgements, apart from those involving estimations (see PBE IPSAS 1 paragraph 140), 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 (PBE IPSAS 1 paragraph 137).

Departments must use Crown accounting policies for preparation of their financial information submitted to the Treasury. These can be found in section 3 of these instructions and on the Treasury's website https://treasury.govt.nz/information-and-services/state-sector-leadership/guidance/financial-reporting-policies-and-guidance/accounting-policies

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 2019*. These financial statements, including the comparatives, have been prepared in accordance with Public Sector PBE Accounting Standards (PBE Standards) – Tier 1. These standards are based mainly on International Public Sector Accounting Standards (IPSAS). Previously published financial statements have been prepared in accordance with New Zealand equivalents to International Financial Reporting Standards as appropriate for public benefit entities (NZ IFRS (PBE)).

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. Public benefit entities (PBEs) are reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders.

3.3 Basis of preparation

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

The financial statements of the Government are to be prepared on an accrual basis.

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

3.4 Judgements and estimations

The preparation of these financial statements of the Government require judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, revenue 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 claim obligations and Government Superannuation retirement benefits, depends critically on judgements regarding future cash flows, including inflation assumptions and the risk free discount rate used to calculate present values.

Since 2010 the Treasury has periodically provided tables of risk-free discount rates and CPI assumptions. **These rates must be used in certain accounting valuations for the purpose of preparing the Financial Statements of the Government.**

Refer https://treasury.govt.nz/information-and-services/state-sector-leadership/guidance/financial-reporting-policies-and-guidance/discount-rates/discount-rates-and-cpi-assumptions-accounting-valuation-purposes for these rates and 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.

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.

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

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

Where these judgements significantly affect the amounts recognised in the financial statements of the Government they are described below and in the following notes.

3.5 Significant accounting policies

3.5.1 Reporting and forecast period

The reporting period is the financial year ending 30 June 2019.

Where necessary, the financial information for State-owned Enterprises and Crown entities that have a balance date other than 30 June has been 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

These financial statements of the Government combine the following entities using the acquisition method of combination:

Core Crown entities

- Ministers of the Crown
- Government departments
- Offices of Parliament
- the Reserve Bank of New Zealand
- New Zealand Superannuation Fund

Other entities

- State-owned Enterprises
- Crown entities (excluding Tertiary Education Institutions)
- Air New Zealand Limited
- Regenerate Christchurch
- Education Council of Aotearoa New Zealand
- Non-company organisations listed in schedule 4 of the Public Finance Act 1989
- Non-listed companies specified in schedule 4A of the Public Finance Act 1989 in which the Crown is sole or majority shareholder
- Organisations listed in Schedule 5 of the Public Finance Act 1989 (Mixed ownership model companies)
- Legal entities listed in Schedule 6 of the Public Finance Act 1989 (Legal entities created by Treaty of Waitangi settlement Acts)

The Crown has a full residual interest in all the above entities with the exception of Air New Zealand Limited, Tāmaki Redevelopment Company Limited (listed in Schedule 4A of the Public Finance Act 1989), Regenerate Christchurch and the entities listed in Schedule 5 of the Public Finance Act 1989 (Mixed Ownership Model Companies).

Corresponding assets, liabilities, revenue 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.

Tertiary education institutions are equity-accounted for the reasons explained in the notes to the Government's financial statements. This treatment recognises these entities' net assets, including asset revaluation movements, surpluses and deficits.

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

3.5.3 Revenue

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.

Tax revenue is recognised when a taxable event has occurred and the tax revenue can be reliably measured. The taxable event is defined as follows:

Revenue type	Revenue recognition point
Source deductions	When an individual earns income that is subject to PAYE
Resident withholding tax (RWT)	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
Income tax	The earning of assessable income during the taxation period by the taxpayer
Goods and services tax (GST)	When the purchase or sale of taxable goods and services occurs during the taxation period
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
Other indirect taxes	When the debt to the Crown arises
ACC levies	The levy revenue is earned evenly over the levy period
Other levies	When the obligation to pay the levy is incurred

The New Zealand tax system is predicated on self-assessment where taxpayers are expected to understand the tax laws and comply with them. Inland Revenue has implemented systems and controls (eg, performing audits of taxpayer records) in order to detect and correct situations where taxpayers are not complying with the various acts it administers.

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 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 revenue

Interest revenue must be accrued using the effective interest 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 revenue each period.

3.5.3.4 Dividend revenue

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

3.5.3.5 Rental revenue

Rental revenue 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 revenue.

3.5.3.6 Donated or subsidised assets

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

If control of the donated assets is conditional on the satisfaction of performance obligations, the revenue is deferred and recognised when the conditions are satisfied.

3.5.3.7 Gains

Gains may be reported in the Statement of Financial Performance when assets are revalued or liabilities are devalued in certain circumstances as described in the accounting policies for those assets and liabilities.

For the purposes of reporting the operating balance before gains and losses (OBEGAL) these gains are excluded from total revenue and presented elsewhere 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 have been met.

3.5.4.3 Grants and subsidies

Where grants and subsidies are at the government's discretion until payment, the expense is recognised when the payment is made. Otherwise, the expense is recognised when the specified criteria for the grant or subsidy have been fulfilled and notice has been given to the government.

3.5.4.4 Interest expense

Interest expense must be accrued using the effective interest 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.

3.5.4.5 Losses

Losses may be reported in the Statement of Financial Performance when assets are devalued or liabilities are revalued in certain circumstances as described in the accounting policies for those assets and liabilities.

For the purposes of reporting the operating balance before gains and losses (OBEGAL) these losses are excluded from total expenses and presented elsewhere in the Statement of Financial Performance.

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 Revenue and Expense 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 Revenue and Expense.

The exchange rate to be used in the translation of assets and liabilities denominated in foreign currencies is provided each month on the Crown's Financial Information System (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 and recognised in the Statement of Comprehensive Revenue and Expense.

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.

Receivables arising from sovereign revenue will be initially recognised at fair value. 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.

This means if agencies currently recognise an expense for the initial fair value write down on sovereign receivables (eg, fines), this fair value write down should now be recognised as a reduction in sovereign revenue. However, subsequent impairment of sovereign receivables continues to be recognised as an expense.

3.5.7 Financial instruments

Financial Instruments are initially recognised at fair value and subsequently classified into one of two measurement categories:

- **at fair value (either through the operating balance 'FVTOB' or comprehensive revenue and expense 'FVCRE')**
- **at amortised cost.**

This classification is made by reference to the purpose and nature of the financial instrument or group of financial instruments.

3.5.7.1 Non-derivative financial assets

General Principles

Financial assets are subsequently measured at amortised cost if they are held for the purpose of collecting contractual cash flows and those cash flows are solely related to payments of principal and interest. Interest, impairment losses and foreign exchange gains and losses are recognised in the statement of financial performance.

Subsequent measurement at FVCRE is for financial assets that are held for the purpose of both collecting contractual cash flows and selling assets, and those cash flows are solely related to payments of principal and interest.

Investments in equity instruments may also be designated at FVCRE where they are not held for trading. Movements in fair value are recognised in the statement of comprehensive revenue and expense and dividends in the statement of financial performance.

All other financial assets not meeting the criteria above are measured at FVTOB. Financial assets may also be designated as FVTOB if doing so eliminates or significantly reduces an accounting mismatch. Gains and 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.

Specific Application

Financial assets classifications and basis of valuation, both when initially recognised and subsequently, are as follows:

Major financial asset type	Measurement classification and basis of valuation
Cash and Cash Equivalents	Amortised cost. 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. They are reported initially and subsequently at amount invested.
Trade and other receivables	Amortised cost. Initially and subsequently reported at their face value, less an allowance for expected losses.
Long-term deposits	Generally amortised cost. They are generally reported at amount invested.
Marketable securities	Generally FVTOB. Based on quoted market price or using a valuation model if there is no active market. The valuation models used generally calculate the expected cash flows under the terms of each specific contract and then discount these values back to present value.
IMF Financial Assets	Amortised cost. Initially measured at cost net of attributable transaction costs and any fair value adjustments. Subsequently measured at amortised cost, applying the effective interest method, less an allowance for expected losses.
Share investments	Generally FVTOB. Based on quoted markets prices for listed share investments. The fair value of unlisted investments is determined from the initial cost of the investment and adjusted for performance of the business and changes in equity market conditions since purchase or using a valuation model as set out in the notes to the financial statements.
Kiwibank mortgages	Amortised cost. Initial recognition, fair value is based on a discounted cash flow model and subsequently measured at amortised cost, applying the effective interest method, less an allowance for expected losses.
Student Loans	FVTOB. Student loans are concessionary loans and classified at FVTOB because loan repayments are contingent on the borrowers earning income. Fair value both initially and subsequently is determined by projecting forward estimated repayments from borrowers under the scheme and discounting them back at risk adjusted discount rates at the measurement date.
Other Advances	Amortised cost. Initially and subsequently reported at their face value, less an allowance for expected losses.

Regular way purchases and sales of all financial assets are recognised on their trade date rather than the settlement date.

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

Discount rates and consumer price index (CPI)

The Treasury publishes a table of risk-free discount rates and these may be applied to valuations where a discount rate or CPI assumption is used.

Student loans must include a built in risk-adjusted discount rate (based on the Treasury's risk-free discount rate) for valuation purposes. The rates and assumptions used must be those published by Treasury –
https://treasury.govt.nz/information-and-services/state-sector-leadership/guidance/financial-reporting-policies-and-guidance/discount-rates/discount-rates-and-cpi-assumptions-accounting-valuation-purposes

3.5.7.2 Allowances for expected losses

An expected credit loss model is used to recognise and calculate impairment losses for financial assets subsequently measured at amortised cost and debt instruments subsequently measured at FVCRE. Financial assets are to be assessed at each reporting date for any significant increase in credit risk since initial recognition

The simplified approach to providing for expected credit losses as prescribed by PBE IFRS 9 is to be applied to trade and other receivables. The simplified approach involves making a provision at an amount equal to lifetime expected credit losses. The allowance for doubtful debts on trade and other receivables that are individually significant are to be determined on an individual basis. Those deemed to not to be individually significant are assessed on a portfolio basis based on the number of days overdue, and taking into account the historical loss experience and incorporating any external and future information. For further guidance, refer to:
https://treasury.govt.nz/publications/guide/guidance-accounting-financial-instruments-under-pbe-ifrs-9-non-financial-entities

The general model prescribed under PBE IFRS 9 is adopted for individual financial assets or groups of financial assets held at amortised cost, other than trade and other receivables. We would expect this model to be applicable only for those entities with investing and lending activities **The expected credit loss must be prepared and calculated in accordance with PBE IFRS 9.**

Financial assets classified at FVTOB are not assessed for impairment as their fair value reflects the credit quality of the instruments and changes in fair value are recognised in the statement of financial performance.

3.5.7.3 Non – derivative Financial Liabilities

General Principles

Financial liabilities are subsequently measured at amortised cost. 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.

Financial liabilities may also be designated as FVTOB if doing so eliminates or significantly reduces an accounting mismatch.

Where a financial liability is held at fair value, the movement in fair value which is attributable to change in the entity's own credit quality is recognised in the statement of comprehensive revenue and expense.

Specific Application

Financial liabilities are categorised using the same measurement categories above and are as follows:

Major financial liability type	Measurement classification and valuation method
Accounts payable	Amortised cost. Initially and subsequently at carrying value as being a reasonable approximation to amortised cost as they are typically short term in nature.
Government stock	Amortised cost. Carrying value based initially on observable market prices and subsequently using the effective interest rate method.
Treasury bills	Amortised cost. Initial and subsequent valuation at carrying value which approximates to amount payable on maturity.
Government retail stock	Amortised cost. Based initially on observable market price and subsequently using the effective interest rate method.
Kiwibank customer deposits	Amortised cost. Measured initially at fair value and subsequently using the effective interest rate method.
Settlement deposits with Reserve Bank	Amortised cost. These represent money deposited with the Reserve Bank by commercial banks, due to the short term nature of these deposits (i.e. overnight) these are initially and subsequently recognised as amounts payable to depositors. Measured initially at fair value and subsequently using the effective interest rate method.
Other borrowings	Generally amortised cost. Measured initially at fair value and subsequently using the effective interest rate method. Some other borrowings are designated as FVTOB to significantly reduce an accounting mismatch.
Issued currency	Not designated, recognised at face value.

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.

3.5.7.4 Derivative financial instruments

Derivative financial instruments are 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 Hedge accounting section below).

Derivatives that are not designated for hedge accounting are classified as 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.

3.5.7.5 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 to which it would improve the relevance of reported results.

In accordance with transition arrangement for hedge accounting under PBE IFRS 9 the hedge accounting requirements of PBE IPSAS 29 continue to be applied.

(a) Cash flow hedge

Where a derivative qualifies as a hedge of variability in asset or liability cash flows (cash flow hedge). The effective portion of any gain or loss on the derivative is recognised in the statement of comprehensive revenue and expense and the ineffective portion is 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 the purchase of an asset in a foreign currency), the amount recognised in the statement of comprehensive revenue and expense is included in the initial cost of the asset or liability. Otherwise, gains or losses recognised in the statement of comprehensive revenue and expense transfer to the statement of financial performance in the same period as when the hedged item affects the statement of financial performance (e.g., when the forecast sale occurs). Effective portions 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 revenue and expense 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.

3.5.8 Inventories

Inventories are recorded at the lower of cost (calculated using a 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, their cost is deemed to be fair value, usually determined through an assessment of current replacement cost at the date of acquisition.

Inventories include unissued currency and harvested agricultural produce (eg, logs, wool). The cost of harvested agricultural produce is measured at fair value less estimated costs to sell at the point of harvest.

3.5.9 Property, plant and equipment

3.5.9.1 Measurement on initial recognition

Items of property, plant and equipment are initially recorded at cost. Cost may include transfers from net worth of any gains or 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 revenue in the Statement of Financial Performance.**

3.5.9.2 Capitalisation of borrowing costs

Generally, Government borrowings are not directly attributable to individual assets. **Therefore, borrowing costs incurred during the period, including any that could be allocated as a cost completing and preparing assets for their intended use are expensed rather than capitalised.**

3.5.9.3 Subsequent measurement

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 and buildings	Land and buildings are recorded at fair value and, for buildings, less depreciation accumulated since the assets were last revalued. Land associated with the rail network and state highways is valued using an estimate based on adjacent use, as an approximation to fair value. Valuations undertaken in accordance with standards issued by the New Zealand Property Institute are used where applicable. 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 accumulated since the assets were last revalued. Valuations are obtained through specialist assessment by New Zealand Defence Force advisers, with the methodology for the valuation having be confirmed as appropriate by an independent valuer.
State highways	State highways are recorded on a depreciated replacement cost basis less depreciation accumulated since the assets were last revalued.
Rail network	Rail infrastructure used for freight services (freight only and dual use lines required for freight operations) are recorded at fair value less depreciation accumulated since the assets were last revalued. Rail infrastructure not required for freight operations and used for metro services is recorded on a depreciated replacement cost basis less depreciation accumulated since the assets were last revalued.
Aircraft	Aircraft (excluding specialised military equipment) are recorded at fair value less depreciation 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 accumulated since the assets were last revalued.
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. Of these, non-land assets are recorded at fair value 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, and where no market exists to provide a valuation. For example, Crown research institutes own various collections, library resources and databases that are an integral part of the research work they undertake. These collections are highly specialised and there is no reliable basis for establishing a valuation. They have therefore not been valued for financial reporting purposes.
Other plant and equipment	Other plant and equipment, which includes motor vehicles and office equipment, are recorded at cost less depreciation and impairment losses accumulated since the assets were purchased.

3.5.9.4 Revaluations

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 PPE are 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 evidence, such as discounted cash flow calculations. If no market evidence of fair value exists, an optimised depreciated replacement cost approach is used as the best proxy for fair value. Where an item of PPE is recorded at its optimised depreciated replacement cost, this cost is based on the estimated present cost of constructing the existing item of PPE by the most appropriate method of construction, less allowances for physical deterioration and optimisation for obsolescence and relevant surplus capacity. Where an item of PPE 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 PPE 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 added 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 deducted from that reserve. Otherwise, losses are reported in the statement of financial performance.

3.5.9.5 Depreciation

Depreciation is charged on a straight-line basis at rates calculated to allocate the cost or valuation of an item of PPE, 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 150 years
Specialist military equipment (SME)	5 to 55 years
State highways:	
Pavement (surfacing)	7 years
Pavement (other)	50 years
Bridges	70 to 105 years
Rail Network:	
Track and ballast	40 to 50 years
Tunnels and bridges	75 to 200 years
Overhead traction and signalling	15 to 80 years
Aircraft (excluding SME)	10 to 20 years
Electricity distribution network	2 to 80 years
Electricity generation assets	25 to 100 years
Other plant and equipment	3 to 30 years

Specified heritage and cultural assets are generally not depreciated.

3.5.9.6 Impairment

The carrying amounts of plant, property and equipment held at cost must be reviewed at least annually to determine if there is any indication of impairment or reversal of impairment.

For assets held at cost, where an asset's recoverable amount is less than its carrying amount, it is reported at its recoverable amount and an impairment loss is 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. After the recognition of an impairment loss, the depreciation charge for the asset must be allocated on a systematic basis over the assets remaining useful life. Any reversal of a previous impairment should be through the statement of financial performance.

Items of plant, property and equipment not carried at cost must be valued with sufficient regularity to ensure that the carrying value is not less than its recoverable amount.

3.5.9.7 Disposals

Realised gains and losses arising from disposal of PPE are generally recognised in the statement of financial performance when the significant risks and rewards of ownership of the asset have transferred to the acquirer. Any balance attributable to the disposed asset in the asset revaluation reserve is transferred to taxpayer funds.

3.5.10 Public private partnerships

A public private partnership (also known as a service concession arrangement) is an arrangement between the Government and a private sector partner in which the private sector partner uses specified assets to supply a public service on behalf of the Government for a specified period of time and is compensated for its services over the period of the arrangement. The costs of the specified assets are financed by the private sector partner except where existing assets of the Government (generally land) are allocated to the arrangement. Payments made by the Government to a private sector partner over the period of a service concession arrangement cover the costs of the provision of services, interest expenses and repayment of the liability incurred to acquire the specified assets.

The assets in a public private partnership are recognised as assets of the Government. If the assets are progressively constructed, the Government progressively recognises work-in-progress at cost and a financial liability of the same value is also recognised. When the assets are fully constructed, the total asset cost and the matching financial liability reflect the value of the future compensation to be provided to the private-sector partner for the assets.

Subsequent to initial recognition:

- **the assets are accounted for in accordance with the accounting policy applicable to the classes of property, plant and equipment that the specified assets comprise, and**
- **the financial liabilities arising from public private partnerships are measured at amortised cost.**

3.5.11 Equity accounted investments

NZ GAAP determines the combination bases for entities that make up the Government reporting entity and is used by public benefit entities to determine whether they control another entity.

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

3.5.12 Biological assets

Biological assets (eg, trees and sheep) managed for harvesting into agricultural produce (eg, logs and wool) or for transforming into additional biological assets must be measured at fair value less estimated costs to sell, 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 must be reported as property, plant and equipment in accordance with the policies for property, plant and equipment.

3.5.13 Intangible assets

Intangible assets are initially recorded at cost.

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 incurred.

Where an intangible asset with a market value is internally generated for nil or nominal consideration it is initially reported at cost, which by definition is nil/nominal.

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 three to five years.

Intangible 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 when the significant risks and rewards of ownership have transferred to the acquirer.

Intangible assets with finite lives are reviewed at least annually to determine if there is any indication of impairment. Where an intangible asset's recoverable amount is less than its carrying amount, it is reported at its recoverable amount and an impairment loss is recognised. Losses resulting from impairment are reported in the statement of financial performance.

Goodwill is tested for impairment annually.

3.5.14 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.**

3.5.15 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 (eg, 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.

3.5.16 Employee benefits

3.5.16.1 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.**

3.5.16.2 Other employee entitlements

Employee entitlements to salaries and wages, annual leave, long service leave, retiring leave and other similar benefits must be 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.

Treasury has issued two excel models (spreadsheets) to calculate long service leave and retiring leave liabilities that comply with PBE IPSAS 25. These models can be downloaded from Treasury Circular 2009/06. 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 models issued by the Treasury in 2009. **The Treasury's central risk-free discount rates and CPI assumptions must be used in these models and those approved by independent actuaries.**

Refer https://treasury.govt.nz/information-and-services/state-sector-leadership/guidance/financial-reporting-policies-and-guidance/discount-rates/discount-rates-and-cpi-assumptions-accounting-valuation-purposes for these rates and assumptions.

3.5.16.3 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.

3.5.17 Insurance contracts

The future cost of outstanding insurance claims liabilities are valued based on the latest actuarial information. The estimate includes estimated payments associated with claims reported and accepted, claims incurred but not reported, claims that may be re-opened, and the costs of managing these claims. Movements of the claims liabilities are reflected in the Statement of Financial Performance. Financial assets backing these liabilities are designated at fair value through the operating balance.

The Treasury's central risk-free rates and CPI assumptions must be used for valuing insurance claim liabilities. Refer - https://treasury.govt.nz/information-and-services/state-sector-leadership/guidance/financial-reporting-policies-and-guidance/discount-rates/discount-rates-and-cpi-assumptions-accounting-valuation-purposes for these rates and assumptions.

3.5.17.1 Reinsurance

Premiums paid to reinsurers are recognised as reinsurance expense in the statement of financial performance from the attachment date over the period of indemnity of the reinsurance contract, in accordance with the expected pattern of the incidence of risk. Prepaid reinsurance premiums are included in prepayments in the Statement of Financial Position.

3.5.17.2 Reinsurance and other recoveries receivable

Reinsurance and other recoveries receivable on paid claims and reported claims not yet paid are recognised as revenue in the statement of financial performance.

Recoveries receivable are assessed in a manner similar to the assessment of outstanding claims and are measured as the present value of the expected future receipts.

3.5.18 Leases

Finance leases must be accounted for in accordance with PBE IPSAS 13.

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 6.3.6.1 and CO (15) 5 which set out the 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.

3.5.19 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 future cash outflows.

3.5.20 Contingent assets and contingent liabilities

Contingent assets and contingent liabilities must be accounted for in accordance with PBE IPSAS 19.

Contingent liabilities and contingent assets are reported at the point at which the contingency is evident or when a present liability is unable to be measured with sufficient reliability to be recorded in the financial statements (unquantifiable liability). Contingent liabilities, including unquantifiable liabilities, are disclosed if the possibility that they will crystallise is more than remote. Contingent assets are disclosed if it is probable that the benefits will be realised.

3.5.21 Commitments

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

Commitments are classified as:

- Capital commitments: aggregate amount of capital expenditure contracted for but not recognised as paid or provided for at balance date, and
- Lease commitments: non-cancellable operating lease commitments.

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

PBE IPSAS 17 *Property, Plant and Equipment*, PBE IPSAS 31 *Intangible Assets,* PBE IPSAS 16 *Investment Property* and PBE IPSAS 27 *Agriculture (biological assets)* all require the disclosure of contractual commitments for the development or acquisition of these types of assets.

PBE IPSAS 13 *Leases* sets out the requirements for disclosure of operating lease commitments.

Cancellable capital commitments that have penalty or exit costs explicit in the agreement on exercising the option to cancel are reported in the Statement of Commitments at the value of those penalty or exit costs (ie, the minimum future payments).

Interest commitments on debts, commitments for funding, and commitments relating to employment contracts are not separately reported as commitments.

3.5.22 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.

3.5.23 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 segments of the Crown are:

- Core Crown: This group, which includes Ministers, government departments, Offices of Parliament, the Reserve Bank of New Zealand and the New Zealand Superannuation Fund, most closely represents the budget sector and provides information that is useful for fiscal analysis purposes. Investments in Crown entities and SOEs are reported at historic cost with no impairment. This ensures losses in those entities are reflected in the appropriate segment.
- State-owned Enterprises: This group includes entities governed by the State-owned Enterprises Act 1986, and (for the purposes of these Instructions) also includes Air New Zealand and companies listed in schedule 5 of the Act. This group represents entities that undertake commercial activity.
- Crown entities: This group includes entities governed by the Crown Entities Act 2004, organisations listed in schedule 4 of the Act, and companies listed in schedule 4A of the Act. These entities have separate legal form and specified governance frameworks.

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* as developed by the *Organization for Economic Co-operation and Development (OECD)*.

3.5.24 Related parties

Related parties of the Government include key management personnel, and their close family members. Key management personnel are Ministers of the Crown, and their close family members are their spouses, children and dependants. Transactions between these related parties and a Government entity are disclosed in these financial statements only if they have taken place within a Minister's portfolio and they are not transactions entered into in the same capacity as an ordinary citizen.

Tertiary Education Institutions, joint ventures and the Government Superannuation Fund are also related parties of the Government due to the Government's influence over these entities. Transactions between these entities and Government entities are separately disclosed where material.

There are no other related parties as no other parties control the Government, and no other parties are controlled by the Government, other than those that are consolidated into the Financial Statements of the Government.

The Government comprises a large number of commonly controlled entities. Transactions between these entities are eliminated in these financial statements and therefore not separately disclosed.

Transactions where the financial results may have been affected by the existence of a related party relationship are disclosed in the financial statements.

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 annual report may be issued only when the Statement of Responsibility is signed by the department's Chief Executive.

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 extended meaning of a department provided by section 33 of the Act, which provides that the following must be taken to be part of a department for the purpose of reporting under Part 4 of the Act:

(a) any activities, other than activities performed by a natural person or separate legal entity, that are funded by way of appropriation administered by the department, and

(b) any bodies or statutory offices, other than natural persons or separate legal entities, that are funded by way of appropriation administered by the department.

For all sub-entities that are not joint ventures (as defined by PBE IPSAS 8 *Interests in Joint Ventures*) the purchase method, as described in PBE IFRS 3 *Business Combinations*, and the consolidation procedures outlined in PBE IPSAS 6 *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 PBE IPSAS 8 *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' revenue.
- *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 revenue 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 (ie, 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 (for non-departmental revenues and expenses GST is included as a separate line item within the statement)**
- **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 PBE IPSAS 9 *Revenue from Exchange Transactions* must be applied. Most other revenue of departments will result from non-exchange transactions, to which PBE IPSAS 23 *Revenue from Non-Exchange Transactions* applies.

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.

The key requirements of PBE IPSAS 9 are:

- Revenue shall be measured at the fair value of the consideration received or receivable (PBE IPSAS 9, paragraph 14).
- 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 (PBE IPSAS 9, paragraph 28).

- 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 (PBE IPSAS 9, paragraph 19).
- Interest revenue shall be recognised using the effective interest method as set out in PBE IPSAS 29, paragraphs 10 and AG17–AG820 (PBE IPSAS 9, paragraph 34(a)).
- Revenue from royalties shall be recognised on an accrual basis in accordance with the substance of the relevant agreement (PBE IPSAS 9, paragraph 34(b)).
- Revenue from dividends shall be recognised when the shareholder's right to receive payment is established (PBE IPSAS 9, paragraph 34 (c)).

If cash or other assets are received from a non-exchange transaction the following requirements of PBE IPSAS 23 apply:

- 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

Revenue 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 revenue with related expenses arising on the same transaction. This treatment is permitted under PBE IPSAS 1 *Presentation of Financial Statements,* paragraph 50.

Departments should note however that PBE IPSAS 9 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.

4.3.2.1 Insurance proceeds

Revenue received from insurance proceeds should not be offset against repairs or impairment expenses. The insurance proceeds should be recognised as miscellaneous revenue (and a receivable recorded) when it is clear the proceeds are receivable.

Insurance proceeds will normally be recognised when the claim has been accepted by the insurance company. However, it is possible that the revenue can be recognised if the claim has not yet been accepted. Assessment about revenue recognition should be based on prior claim experience and expert input; if entities are virtually certain a claim will be accepted then this should be recognised. In this situation entities need to estimate the amount they expect to receive under the claim.

Where a receivable cannot yet be recognised, departments should consider whether a contingent asset may need to be disclosed.

In some instances insurance proceeds may not be received in the same financial year as the expense (the impairment of the damaged asset) is incurred. This may result in departments reporting a deficit in the year the expense is incurred and a surplus in the following year when the insurance proceeds are received. Where this situation occurs the department may seek approval to retain the surplus arising from the receipt of these insurance proceeds (refer section 4.4.3). For forecasting purposes it is highly likely approval will be given to departments to retain the surplus and this retention of surplus should be factored into the department's forecasts. In the event this is caused by a natural disaster where a number of departments are affected, the Treasury may instigate a process to seek approval to retain surpluses for all affected departments.

4.3.3 Losses arising from natural disasters

A natural disaster (eg, an earthquake) may impact on the operations of a department and result in losses being incurred. These losses may arise from departmental assets being destroyed or being damaged. This section outlines the accounting policies. Refer section 6.4.5 for details on the appropriation requirements.

4.3.3.1 Destroyed assets

Departmental assets that have been destroyed in a natural disaster will need to be written off.

If the assets are based on the cost model (ie, carried at cost less any accumulated depreciation and any impairment losses) the full amount of the asset write-off will need to be recognised as an expense.

For assets carried at revalued amounts the accounting standards are unclear on the treatment. The Treasury's recommendation is that the full amount of the asset write-off should be recognised as an expense. In addition, if the portion of the revaluation reserve that related to the destroyed assets is identifiable, then this portion of the revaluation reserve should be transferred to general funds.

Parliamentary authority to replace destroyed departmental assets is provided by section 25 of the Act, with approval processes and limits outlined in Cabinet Office circular CO (15) 5. Refer section 6.5.5.2 for details on replacement of non-departmental assets.

4.3.3.2 Damaged assets

Assets that are damaged in a natural disaster may need to be impaired or revalued to reflect the extent of the damage. The recognition of any impairment will be dependent on the materiality of the damage. Ideally, the impairment will be recognised when the impairment event occurs. In some cases it may not be possible to estimate the damage at the time of the impairment event. **However, once a reliable estimate of the damage can be made an impairment or revaluation will need to be recognised.**

The recording of impairments will depend on whether the assets are based on the cost model or carried at revalued amounts:

- If the assets are based on the cost model the asset impairment will need to be recognised as an expense.
- If the assets are carried at revalued amounts the impairment is treated as a revaluation decrease. The full amount of the revaluation can be taken against the revaluation reserve if the reserve for the class of asset damaged is sufficient.
- If the revaluation reserve for the class of asset damaged is not sufficient to cover the impairment any residual amount would need to be recognised as an expense (refer to section 6.4 for recording of other expenses).

4.3.3.3 Repairing assets that have been impaired

Where an asset's service potential has been impaired, any repair costs incurred to restore that asset's service potential back to its pre-impaired condition may be capitalised.

In many instances repairs are likely to restore service potential and therefore be treated as departmental capital expenditure. However, if the costs are for damage that has not affected the service potential of an asset, the repair costs cannot be capitalised and will need to be expensed.

The decision to capitalise or expense costs will need to be determined by departments pragmatically on a case by case basis.

Where the repairs are able to be capitalised, then Parliamentary authority to repair the damaged departmental assets is provided by section 25 of the Act, with approval processes and limits outlined in CO (15) 5. Refer section 6.5.5.2 for details on replacement of non-departmental assets.

4.3.4 Capital charge

The capital charge ensures that prices for goods and services produced by government departments reflect full production costs; allows comparison of the costs of output production with those of other producers (whether in the public or private sector); and creates an incentive for departments to make proper use of working capital and to dispose of surplus fixed assets.

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.

PBE standards define what a financial instrument is and whether an instrument is a financial asset, financial liability or equity (these definitions are currently in PBE IPSAS 28 *Financial Instruments: Presentation*)).

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 October 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 the Treasury.

PBE IPSAS 5 *Borrowing Costs* states that "borrowing costs are interest and other costs incurred by an entity in connection with the borrowing of funds". IPSAS 5 paragraph 4, 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".

The capital charge, as applied to departments, is not a borrowing cost in accordance with PBE IPSAS 5.

Capital charge is calculated and invoiced by the Treasury twice a year; once on departments' 31 December net asset balances (taxpayer funds) and then again on their audited 30 June net asset balances. The rate used for calculation of capital charge is the public sector discount rate.

Further details regarding the capital charge regime and the applicable public sector discount rate can be found on the Treasury website: https://treasury.govt.nz/information-and-services/state-sector-leadership/guidance/financial-reporting-policies-and-guidance/discount-rates.

Where a department has received gifted assets then the department's net assets may be adjusted for these gifted assets prior to calculating capital charge.

Where part of a department's assets were initially provided by a party other than the Crown (eg, were funded by third party fee payers (ie, memorandum account activity), the department's net assets are adjusted to exclude accumulated surpluses or deficits in memorandum accounts.

Departments that wish to take advantage of this partial exemption from capital charge must provide satisfactory evidence to the Treasury that these assets are funded (or gifted) by a party other than the Crown.

Where departments have memorandum accounts, details of the memorandum account balances must be provided to the Treasury as at 31 December and 30 June for each memorandum account to enable the Treasury to make adjustments to the department's capital charge invoice for both accumulated surpluses and accumulated deficits.

The calculation of capital charge to be paid by departments (on a six monthly basis) is:

	Net assets (taxpayer funds)
Minus	**gifted assets**
Minus	**the accumulated surpluses for services subject to memorandum accounts**
Plus	**the accumulated deficits for services subject to memorandum accounts**
Equals	**Net assets subject to capital charge**
Multiplied by	**public sector discount rate**
Divided by 2*	
Equals	**Capital charge payable**

*Note – the Treasury invoices departments twice a year hence the calculation is divided by two.

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 PBE IPSAS 17 *Property, Plant and Equipment*. PBE IPSAS 17 does not apply to the following types of property, plant and equipment:

- property, plant and equipment classified as held for sale in accordance with PBE IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*
- biological assets related to agricultural activity (see PBE IPSAS 27 *Agriculture*), 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 PBE IPSAS 16 *Investment Property* is relevant), and
- licences and patents (PBE IPSAS 31 *Intangible Assets* is relevant).

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

PBE IPSAS 17 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.

Where an item of property, plant and equipment is transferred within the Crown this must be transferred at the gross amount of the asset. All related accumulated depreciation must be transferred also.

4.4.2 Computer software

Computer software must be classified as an intangible asset and accounted for in accordance with PBE IPSAS 31 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 PBE IPSAS 17.

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 PBE IPSAS 31 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 PBE IPSAS 31.

- Costs associated during the research phase of a software development should not be capitalised, but must be expensed (PBE IPSAS 31, paragraph 52). Activities occurring in the research phase include the search for and selection of alternatives (PBE IPSAS 31, paragraph 54).
- 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
  - the usefulness or market value of the software can be demonstrated, and
  - the expenditure attributable to the software development can be measured reliably (PBE IPSAS 31, paragraph 55).
- 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 (PBE IPSAS 31, paragraph 64).
- 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 (PBE IPSAS 31, paragraph 65).
- 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 (PBE IPSAS 31, paragraph 27).

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 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 any 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**
Minus (plus)	**The surpluses (deficits) for that financial year for services subject to memorandum accounts**

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. Any 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.
- Surpluses on third-party funded services that are subject to memorandum accounts are deducted from the operating surplus to avoid the Crown being subsidised by third party activities and because the surplus will be required to fund expenses on these third party services in a subsequent (deficit) year. Deficits on third-party funded services that are subject to memorandum accounts are added to the operating surplus to avoid third party activities being subsidised by the Crown.

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 PBE IPSAS 14 *Events After the Reporting Date*. The obligation to repay the surplus is a condition that existed at the balance date. Where a department is in deficit, no provision is required.

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 no later than two months after year-end (ie, by 31 August).

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. Where a capital injection is considered to be more appropriate then a cabinet paper with a detailed business case will need to be submitted for approval by Cabinet. Departments should discuss the intention to seek approval to retain surpluses (or a capital injection where appropriate) with their Vote Analyst.

4.4.4 Commitments

Commitments are future expenses and liabilities to be incurred on contracts that have been entered into at balance date. **Information on non-cancellable lease commitments and non-cancellable capital commitments must be disclosed in the Statement of Commitments.**

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.** PBE IPSAS 17 *Property, Plant and Equipment*, PBE IPSAS 31 *Intangible Assets,* PBE IPSAS 16 *Investment Property* and PBE IPSAS 27 *Agriculture (biological assets)* all require the disclosure of contractual commitments for the development or acquisition of these types of assets, or
- **Non-cancellable operating leases** (as required by PBE IPSAS 13 *Leases*) **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.**

Cancellable capital commitments that have penalty or exit costs explicit in the agreement on exercising the option to cancel must be reported in the Statement of Commitments at the value of those penalty or exit costs (ie, the minimum future payments).

4.5 Forecasting policies

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

Departments' forecasts are a crucial part of the annual Budget and fiscal management cycle. Consolidated forecasts are used to:

- feed into the government's decisions around their fiscal strategy
- assist Ministers' decision making about the affordability of the Budget package at the whole of Crown level, and
- determine the amount and timing of the Government's borrowing programme.

Given the importance of fiscal forecasts in the decision-making process, departments' forecast processes must be robust to produce supportable and credible forecasts. This covers both accrual and cash forecasts. Departments' own management review and quality assurances of the forecasts are a vital part of the process and Chief Executives are required to sign-off on the forecasts in the form of a statement of representation.

Forecast financial information must comply with PBE FRS-42: *Prospective financial statements* and NZ GAAP as it relates to prospective financial statements.

4.5.1 General forecasting policies

Forecasts (both departmental and non-departmental) are to be prepared on a midpoint estimates basis using best professional judgment, reflecting information and circumstances at the date the forecasts are provided. Appropriate quality analysis of the forecast is required before submitting to the Treasury. When updating forecast information (both the five-year forecasts and monthly forecast tracks), departments should use their best estimates of the actual spending patterns. The Treasury recommends that monthly forecast tracks are prepared at the same time as preparing the five-year fiscal forecasts where possible.

Forecasts for all periods and outyears should be realistic and credible. Multi-year appropriation expenditure (for example) should be realistically spread across their duration, not "front-loaded". Capital expenditure (in particular) can be subject to slippage and forecasts should allow sufficient time for approval, consent and tendering processes to be completed. The timing of a transaction can be different under accrual and cash accounting practices and this timing difference should be reflected in the separate accrual and cash flow forecast schedules.

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 (ie, over $10 million) with the counter-party, and if the transactions are to occur over a period, then this confirmation should include the phasing of the expenditure. Both sides to a material inter-entity transaction must have the same basis for their forecasts. For further guidance on eliminating inter-entity transactions and balances refer to the Treasury's elimination framework available on the Treasury website at:
https://treasury.govt.nz/information-and-services/state-sector-leadership/guidance/financial-reporting-policies-and-guidance/accounting-policies

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 and long-term rates of return in large investment funds (as set out in section 4.5.2 below) should be forecast.

Refer also section 6.2.3 for the Treasury's expectations on entities providing financial information to the Treasury.

The Treasury provides departments with feedback on their forecasting performance at the end of each financial year.

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 (eg, 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 revenue and interest expense are recognised using the effective interest 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 revenue 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 are zero due to forecast exchange rates being fixed at the rate at the forecast reference date, as are interest rate curves and other assumptions (eg, 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.

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.

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.

5 Cost accounting policy parameters

5.1 Disclosing cost accounting policies

The Act requires departments to:

- identify in the Estimates, and supporting information relating to the appropriations, the amount of and other specific information about each appropriation authorised for that financial year by an Appropriation Act (sections 14, 15A, 15B and 15C of the Act)
- report after the end of the financial year the specific performance information for each appropriation for year-end reporting purposes, which must include an assessment of what has been achieved with the appropriation in the financial year; and a comparison of the actual expenses or capital expenditure incurred in relation to the appropriation in the financial year with the expenses or capital expenditure that were appropriated or forecast to be incurred (sections 19A, 19B and 19C of the Act).

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 6.4 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 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 (or a category of similar outputs within a multi-category appropriation) 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.

Investments are the commitment of capital or balance sheet resources to the delivery of government services with the expectation of receiving future benefits.

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

The Act makes departmental Chief Executives responsible for the financial management, financial performance and financial sustainability of their departments (section 34 of the Act) and specifies their responsibilities in respect of non-departmental activity administered by the department (section 35 of the Act).

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**
- **financial management and financial performance of any bodies, activities or statutory offices that are funded by way of an appropriation administered by the department and that are not natural persons or separate legal entities**
- **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 can obtain these publications from the Treasury website.

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 (as defined by the Act)

may also impact on the manner in which the Chief Executive meets his or her responsibilities. Cabinet Office circulars limiting departmental chief executives' authority to approve certain types of departmental spending (with spending in excess of those limits requiring approval of the responsible Minister or of Cabinet) 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). Financial delegations from the Minister responsible for an appropriation to the Chief Executive are a specific example of Cabinet decisions that impact upon the financial management of activities a department manages on behalf of the Crown (ie, non-departmental activities).

6.2 Reporting obligations

6.2.1 Annual reporting requirements of departments[2]

6.2.1.1 Departmental 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

Section 45A of the Act requires the following items to be included in a department's annual report as a separate statement from the annual financial statements:

- a statement of the budgeted and actual expenses and capital expenditure incurred against each appropriation administered by the department and each category of expenses or non-departmental capital expenditure included in a multi-category appropriation administered by a department
- for each appropriation administered by the department, details of the document in which the end-of-year performance information for the appropriation for the previous financial year is presented to the House of Representatives
- a statement of expenses and capital expenditure incurred without appropriation or other authority, or in excess of an existing appropriation or other authority, 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

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2 Further guidance for departments on preparing their annual reports can be found in the document *Departmental Annual Reports and End-of-Year Performance Information on Appropriations.* This document is available on the Treasury's website: https://treasury.govt.nz/publications/guide/year-end-reporting-departmental-annual-reports-and-end-year-performance-information-appropriations

- a statement of the amount of any capital injection authorised, under an Appropriation Act, to be made to the department compared with the actual amount of any capital injection made to the department, and
- a statement of any capital injection made to the department without authority, or in excess of an existing authority, under an Appropriation Act, together with an explanation of the reasons for the unauthorised capital injection.

6.2.1.2 Non-departmental reporting

A number of departments administer non-departmental activities on behalf of the Crown. The department is responsible for the effective and efficient administration of contracts or payments for non-departmental activities or of non-departmental revenue or receipts. Section 35 of the Act makes the chief executives of departments accountable for the financial management of non-departmental 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, revenue, 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 disclosures made should materially comply with GAAP to the extent possible. The schedules are to be audited.

Materially comply in this context means that at a minimum departments should include notes to the non-departmental schedules (where relevant) and should include explanations for major variances against original budget (ie, the initial approved budget for that period that is set prior to the commencement of that reporting period and included in the main estimates).

The non-departmental schedule of assets should not include any value that a department is recording for "equity investments in SOEs and/or Crown entities" (eg, capital injections made to SOEs and/or Crown entities). Instead, a department can include a disclosure that it monitors a number of SOEs or Crown entities, listing them if relevant. A statement that the investment in these entities is recorded within the Crown financial statements on a line-by-line basis and that no disclosure is made within the department's schedule of assets is sufficient.

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 appropriations 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, as a minimum concise variance/exception reports should be provided; it is not necessary to provide full financial statements each month. 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[3], Annual Report and end of year reporting against appropriations
- *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 and concisely 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, Supplementary Estimates of Appropriations, and any adjustments to these**
- **budget and appropriation monitoring**

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3 Further guidance for departments on preparing their SOIs can be found in the documents *"Performance Expectations - "What's Intended to Be Achieved"* and *"Performance Expectations - "How Performance Will Be Assessed"* issued by the Treasury in December 2013. These are available on the Treasury's website: https://treasury.govt.nz/information-and-services/state-sector-leadership/guidance/strategic-intentions-and-statements-intent

- **monitoring and control of Crown revenue, expenditure, assets and liabilities (refer also to section 6.5 "Crown revenue, expenditure, liabilities and assets")**
- **forecasting and monitoring of banking activity (refer also to section 6.6 "Banking")**
- **monitoring and control of trust money (refer also to section 6.7 "Trust money")**
- **monitoring and control of contingent liabilities (refer also to section 6.8 "Contingent liabilities")**
- **preparation of the financial statements of the Government of New Zealand**
- **explanation of material variances to forecast, and**
- **management of physical, biological and intangible assets.**

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 (as specified in Section 29A of the Act). These requirements are set out in Treasury Circulars.

When providing reports and financial information to the Treasury, Chief Financial Officers should keep in mind the Treasury's expectations for these. These expectations apply regardless of whether the information provided relates to monthly or annual actuals, estimated actuals or forecasts and applies to information provided on both a cash and accruals basis. Reports and financial information should be:

- submitted on time (as per timetables published in Treasury Circulars)
- appropriately reviewed and authorised
- free from material errors and omissions
- complete, accurate and internally consistent, including any associated checklists, other supporting information or certification
- accompanied by clear and accurate analysis
- credible and supportable, particularly where judgements are made (eg, measuring complex obligations. What significant assumptions were made? What judgements were required?)
- consistent with other information provided to the Treasury or published
- in compliance with Cabinet decisions where applicable
- in accordance with Crown accounting policies (refer section 3) and the forecast policies (refer section 4.5)
- subject to effective internal controls that provide assurance over the information delivered to the Treasury, and
- a correct reflection of inter-entity transactions and balances that have been confirmed and agreed with other entities as required. Refer to the Eliminations Framework available on the Treasury's website for further guidance: https://treasury.govt.nz/publications/guide/eliminations-framework-financial-statements-government-under-nz-ifrs

The Treasury further expects entities to:

- regularly inform their stakeholders regarding the financial information that they report to the Treasury, particularly if there are significant departures from previous forecasts
- proactively identify and resolve issues promptly, and
- manage other key relationships (eg, auditors). This will include being proactive and communicating constructively.

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 departmental external financial reporting" (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 "Accounting policies for external financial reporting by the Government" (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 made provided that it is the only transfer under section 26A 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.

Departments should ensure that there is sufficient authority for all expenses, capital expenditure and departmental capital injections prior to expenditure being incurred. In instances where the original appropriation amount is expected to be exceeded, departments must ensure sufficient authority is obtained to use Imprest Supply prior to incurring expenditure. This applies to both departmental and non-departmental expenses and capital expenditure as well as capital injections to departments.

While Baseline Updates are the normal process for a technical change without significant policy issues, if it is known that the expenditure will (or is likely to) be incurred before the Minister of Finance has approved the Baseline Update, and this will result in unappropriated expenditure, authority to use Imprest Supply must be obtained from joint Ministers or Cabinet prior to incurring expenditure. This ensures that when the expenditure is incurred, authority for the additional or new expenditure item is already in place, avoiding unappropriated expenditure.

6.3.2 Emergency expenditure requiring Minister of Finance approval

In the event a state of emergency or state of civil defence emergency is declared, or a situation occurs affecting public health or safety that the Government declares to be an emergency, section 25 of the Act provides authority for the Minister of Finance to approve the incurring of expenses or capital expenditure to the extent necessary. Section 25A of the Act also provides authority for the Minister of Finance to approve a capital injection to meet an emergency or disaster described in section 25(1) of the Act.

The Government's policy on civil defence expenditure is contained in the National Civil Defence Emergency Management 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.

Once the Minister of Finance has given an approval under section 25(2) of the Act this enables expenses or capital expenditure to be incurred in accordance with that approval to meet the emergency whether or not an appropriation is available until the approval is revoked or the state of emergency to which the Minister’s approval relates no longer exists.

The Minister's approval is likely to require all such expenses or capital expenditure to be managed and accounted for in accordance with requirements issued from time to time by the Treasury. These requirements include:

- **departments proposing to make use of the approval must consult with the Secretary to the Treasury before doing so, and**
- **departments incurring expenditure without appropriation under the approval to record this expenditure separately from other approved expenditure.**

6.3.3 Other expenditure requiring Minister of Finance approval

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 up to the greater of $10,000 or 2% of the total amount appropriated for that appropriation. These approvals can be given in the financial year or not later than 3 months after the end of that financial year. Section 26B approvals can only be given in respect of expenditure that is within the scope of an existing appropriation. Expenditure that falls outside of the scope of an existing appropriation cannot be approved by the Minister of Finance but instead must be validated by Parliament in accordance with section 26C of the Act.

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. The contents of the Treasury's report is then used to prepare the Appropriations (Confirmation and Validation) Bill for confirmation of Orders in Council made under section 26A, confirmation of Ministerial approvals under section 26B, validation of section 26C instances of unappropriated expenditure and validation of section 26CA instances of unauthorised capital injections. That report is then presented to House as required by section 26C(2).

6.3.4 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.

6.3.5 Insurance and risk management

6.3.5.1 Departmental 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 (ie, 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 (ie, 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. Departments should consider the following questions when deciding on insurance:

- What is the assessed risk of assets not being available to provide public services in the future, and what is the most appropriate way to manage it?
- Are risk assessments being done to inform decisions about insurance, including likely costs to replace assets?

- Is the right amount and nature of insurance cover being obtained to ensure that public services can be continue to be delivered?
- Is insurance being obtained in the most cost effective way?
- How much can be prudently borrowed to replace uninsured assets?
- Has the risk of all uninsured assets been assessed centrally, and is the risk being managed appropriately?

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.

6.3.5.2 Risk management of Crown assets

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.

6.3.6 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. The term “lend money” is defined in section 2 of the Act and includes deferring payment for any goods or services supplied or works constructed for any person, organisation, or government; entering into hire purchase agreements or agreements that are of the same or a substantially similar nature; and entering into finance

lease arrangements or arrangements that are of the same or a substantially similar nature; but does not include selling or supplying goods or services on credit for a period of 90 days or less from the date the credit is supplied. Under section 65L the Minister may lend money to persons or organisations if it appears to the Minister to be necessary or expedient in the public interest to do so.

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" is defined in section 2 of the Act and includes entering into hire purchase or agreements that are of the same or a substantially similar nature (eg, 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 (ie, 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.

6.3.6.1 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 Cabinet Office Circular CO (15) 5 in relation to purchase, development or leasing of fixed assets. This Cabinet Office circular can be found on the DPMC website.

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

- **the parties to the lease an/d 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 (eg, 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 (eg, 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 the 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.

6.3.7 Memorandum accounts

Memorandum accounts record the accumulated balance of surpluses and deficits incurred in the provision of certain outputs on a full cost-recovery basis. These accounts are used to separately disclose the cost of such outputs over the years, given that such information would otherwise just be aggregated as part of an entity's financial position.

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.

Except where prior approval for alternative arrangements has been obtained from the 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
- where revenue is received in advance as defined under generally accepted accounting practice
- where revenue results from internal charging within a department, or
- for 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.

Each memorandum account is to be approved jointly by the Minister of Finance and the Minister responsible for the relevant appropriation and the departments responsible Minister (if different from the Minister responsible for the appropriation).

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.

The balance of each memorandum account is expected to trend to zero over a reasonable period of time with interim deficits being met either from the department's balance sheet or by a capital injection sought from the Crown.

Any surpluses arising in the memorandum accounts are retained and not paid to the Crown as part of the department's overall surplus. Where a deficit arises this is not deducted from the department's overall surplus. This avoids third parties subsidising Crown activities (when in surplus) or the Crown subsidising third party activities (when in deficit). This approach allows retention of surpluses from third party activities for funding a future deficit while also assuming that a deficit derived from third party activities will only require approval of a capital injection from the Crown, where such deficit is not able to be funded from the department's working capital. Refer to section 4.4.3 of these instructions for the calculation of departments' provision for return of operating surplus.

Both surpluses and deficits derived from memorandum accounts impact on a department's capital charge. Refer to section 4.3.4 for guidance on how memorandum account activity is taken into account for the calculation of capital charge.

As memorandum account surpluses are provided by third party recipients, they are attributable to those third parties rather than to the Crown. Therefore follows that, memorandum account surpluses should not be used for other purposes.

Departments whose memorandum account revenue is consistently less than the corresponding expenses may seek a capital contribution from the Crown to offset these losses and maintain its working capital in the short term. **Prior to seeking a capital contribution departments should first ensure that they are providing the services in the most cost-effective way; that the underlying business model is robust, and that the cost structure for the services is efficient and effective, rather than seeking to shift further costs on to third parties.** Departments should discuss any intention to seek a capital injection with their Vote Analyst who may be able to provide further guidance on the steps to be worked through by the department in the event of a downtown in third party revenue.

If after taking the required steps to address the downturn in third party revenue, the department still believes a capital contribution is required, the department must prepare a Cabinet paper setting out the business case for a capital contribution. Business cases should include 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.**

Consideration of providing a capital injection will be on the basis of the assumption that:

- The memorandum account deficit will need to be managed over a period of time through a combination of revised fee setting and increased business efficiencies.
- Recovery of past deficit funding associated with those services needs to be made over a period of time and will include the accumulated losses brought forward. The period of time taken to recover these deficits will be set by the individual memorandum account market conditions the service is trying to address.
- A pricing model to ensure recovery of the full costs of providing services over the long-term will need to be factored into the fees rates set to ensure that the full costs of providing services will be recovered over the long-term. This will help determine the future pricing models that should be adopted.
- Where a capital withdrawal is not directly attributed to surpluses generated from the activities covered by the memorandum account, then any reduction in capital charge could still be applied to the memorandum account activities in accordance with the agency's cost allocation methodology.

- Where a memorandum account is in a net deficit position and the Crown has consequently made a capital injection as a result of the department not being able to absorb the deficit from department's working capital, then any future surpluses should generate a positive cash position, and that positive cash should then be used to action a corresponding capital withdrawal.
- An entity should repay capital injections (that it received to fund memorandum account deficits) by way of a cash payment to the Crown over the same period of time as the memorandum account cycle.

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

Memorandum accounts should be separately disclosed in a department's equity section of its Statement of Financial Position within the department's annual report. Notes to the accounts should provide information for each memorandum account on how its opening balance is adjusted by the end-of-year surplus or deficit in relation to the fee revenue and expenditure relating to that memorandum account.

Departments must ensure that there is regular monitoring of all memorandum account balances, at least quarterly. Refer to additional guidance provided by the Office of the Auditor General in relation to the 2011/12 audit results *Memorandum Accounts in Central Government* http://www.oag.govt.nz/2013/central-govt/part11.htm

Some departments operate other 'hybrid' memorandum accounts as a means to provide transparency to fee payers on how revenues contributed by them have been applied to expenditure incurred by the Crown. Examples include activities that include a combination of both departmental and non-departmental elements where the matching revenue and expense elements are not under the control of the same entity. While it may be desirable for agencies to continue reporting on such activities, they are considered outside the scope of the requirements in these instructions.

Other useful information can be found in the Treasury publication *Guidelines for Setting Charges in the Public Sector* (April 2017)[4] and the Office of the Auditor General's good practice guidelines *Charging fees for Public Sector Goods and Services* (June 2008)[5].

4 Available on the Treasury website: https://treasury.govt.nz/publications/guide/guidelines-setting-charges-public-sector-2017-html

5 Available on the Office of the Auditor General's website: http://www.oag.govt.nz/2008/charging-fees

6.3.8 Management of departmental assets

Departments do not require separate annual appropriations for purchasing departmental assets. Instead, section 24 of the Public Finance Act provides a permanent legislative authority for departments to manage their assets. Where a department (other than intelligence and security departments) anticipates that it will need additional capital to purchase departmental assets, approval must be obtained for a capital injection. Capital Injections must be authorised in an Appropriation Act. They can be obtained through Cabinet (or joint Ministers in certain circumstances) and it must be agreed that in the interim (prior to being included in the Supplementary Estimates) the capital injection be met from Imprest Supply. This requirement for departmental capital injections replaces the previous net asset regime.

Expectations for capital asset management are set out in Cabinet Office Circular CO (15) 5 *Investment Management and Asset Performance in the State Services*. This circular is a companion circular to CO (18) 2 *Proposals with Financial Implications and Financial Authorities*[6] These expectations consolidate Cabinet's expectations relating to all aspects of asset management in departments (and Crown entities).

CO (15) 5 sets out:

- The scope and purpose of the investment management system
- Roles of Cabinet and other stakeholders in the system and in major investment decisions
- Expectations relating to the management, assurance, procurement and reporting of investments by departments and crown entities
- Expectations relating to asset management and reporting
- Incentives to improve investment and asset performance in agencies and potential implications for under performance.

This circular applies to all new variations on existing projects for the purchases or development of departmental fixed assets, and to all changes or additions to existing fixed assets and operating leases for fixed assets.

In general, thresholds are as follows:

- **Investments with a whole of life cost (WOLC) less than $15 million require the approval of the departmental chief executive**
- **Investments with a WOLC between $15 million and $25 million require approval of the responsible Minister**
- **Investments with WOLC greater than $25 million require Cabinet approval.**

6 These and other Cabinet Office circulars can be found at: https://www.dpmc.govt.nz/publications/archive?field_metadata_pubtypespubsdb_tid=805

The Treasury expects departments, in particular all staff handling submissions for Cabinet, Cabinet committees and baseline updates, to be familiar with this circular. The material in this circular should be conveyed to all departments, Crown agents, and other Crown entities as applicable.

6.4 Departmental other expenses

6.4.1 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 related 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 (ie, 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 Expense category exists because there are 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.

Note that some items reported as Other Expenses in the financial statements will not require an appropriation, because for the purposes of the Public Finance Act they will be regarded as remeasurements (for more information on remeasurements, please refer to *Measuring Remeasurements: Treasury Application Guidance* issued by the Treasury in February 2018. https://treasury.govt.nz/sites/default/files/2018-04/remeasurements-guidance.pdf).

6.4.2 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.

6.4.3 Asset devaluations

Asset devaluation expenses (where there are insufficient revaluation reserves) must generally be considered output costs because departments will normally only hold assets necessary for the production of their outputs. Where a department considers asset devaluations to be Other Expenses the onus is on departments to demonstrate that the asset devaluation expenses relate to non-output assets and therefore are to be considered Other Expenses.

6.4.4 Restructuring expenses

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.

6.4.5 Asset write-off and impairment expenses arising from natural disasters

Expenses arising from asset write-offs and impairments which have been incurred as a result of a natural disaster should be treated as departmental other expenses. However, there could be some instances where these expenses may be considered as part of the departmental outputs. In these circumstances, the onus is on departments to prove it is appropriate to treat these expenses as output costs rather than as a departmental other expense.

6.4.6 Disclosure of other expenses

Departments must disclose the nature of other expenses in a note to the financial statements.

6.4.7 Summary

In summary, departmental Other Expenses are likely to include:

- 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
- asset devaluation expenses where these relate to non-output items
- restructuring costs, but only where these relate to decisions to cease producing certain outputs, and
- asset write-off and impairment expenses arising from natural disasters.

6.5 Crown revenue, expenditure, assets and liabilities

6.5.1 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.

6.5.2 Authority to operate Crown bank accounts

Under section 65R 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 65R of the Act (refer also to section 6.7 of these Treasury Instructions, "Banking").

6.5.3 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 in accordance with GAAP**
  - **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 (or pro-rated amount where more appropriate) of distribution should be approved by the Treasury.

6.5.4 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 (ie, 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 6.6 of these Treasury Instructions ("Banking"), any Notice of Delegation Regarding Crown Bank Accounts issued by the Treasury and the delegated authority obtained from the Minister responsible for the non-departmental appropriation that the Crown payment relates to**
- **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.

6.5.5 Management of Crown assets

6.5.5.1 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 "Accounting policies for external financial reporting by the Government" (section 3 of these 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.

6.5.5.2 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.

Section 6.3.8 of these Treasury Instructions summarises the expectations for capital asset management that are now set out in Cabinet Office Circular CO (15) 5 *Investment Management and Asset Performance in the State Sector.* This circular includes approval thresholds on proposals to dispose of Crown assets:

- All proposals to dispose of Crown assets that have significant policy implications require Cabinet approval.
- All proposals to dispose of Crown assets that do not have significant policy implications require approval of the responsible Minister.

6.5.6 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 "Accounting policies for external financial reporting by the Government" (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.**

6.5.7 Provision of information to the 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. Section 79 of the Act gives the Treasury the statutory base to request other information from departments.

6.5.8 Public Private Partnerships

Departments contemplating Public Private Partnerships must contact the Treasury’s Infrastructure Transactions team.

6.6 Banking

6.6.1 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 6.7 of these 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.

6.6.2 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 (refer section 6.5.2 of these Treasury Instructions "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) of the Act 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.

6.6.3 Departmental bank accounts

The 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 6.7 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.

6.6.4 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 arises from departmental activities, which is to be distinguished from activities carried out on behalf of the Crown, or Crown activities. **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 65R 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 as to why it is necessary and the Treasury will arrange it for them. One example of a transfer may be where a department has received funds from another party into the wrong bank account and the department needs the ability to transfer them to the correct account.

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. Refer to section 6.6.8 of the Treasury Instructions ("Cash payment schedule") for more information on cash flows and requirements.

6.6.5 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.

6.6.6 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.

6.6.7 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.

6.6.8 Cash payment schedule

Departments, as part of their budgeting process, must estimate after each fiscal update the cash flows of authorised department's operations and any Crown activity managed by the department that Ministers have agreed will be sourced from the Crown. This figure is then used, in conjunction with the liquidity needs of the department, to estimate the total cash requirement for the year. This cash requirement is broken down into disbursements to be made at regular intervals by the Crown to ensure that all department and subsidiary Crown bank accounts are sufficiently funded to enable all incurred and authorised (statutory and financial) non-departmental expenses and capital expenditure are settled. The cash payment schedule is arrived at through departmental negotiation with the Treasury Vote Analyst and is updated into CFISnet via the cash module. Cash is disbursed in New Zealand dollars.

Departments must negotiate a cash payment schedule with the Treasury prior to the commencement of each financial year and update it as required by Treasury after baseline updates. 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 schedule is required for departmental bank accounts.

It is good practice to agree the cash payment schedule for the upcoming year and enter it into the CFISnet module shortly after the main estimates and the supplementary estimates have been finalised.

Any subsequent changes to the cash payment schedules must also be agreed with the Vote Analyst. Notice of any changes (ie, 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 demonstrate that cash requests do not exceed authorised (statutory and financial) departmental expenses and capital injections that Cabinet has agreed will be sourced from the Crown. This task is completed through the cash reconciliation within the CFISnet cash module.

6.6.9 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 (ie, 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.

6.7 Trust money

6.7.1 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 the law recognises that a person other than the Crown or department has a property claim on that money (a beneficial interest) in the circumstances described in section 66. Money set aside by the Crown or department for a particular purpose will normally not be trust money where there is no directly identifiable beneficiary.

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.

6.7.2 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 the 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 <u>whether in respect of trust money as defined in the Act, or otherwise</u>.

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.**

6.7.3 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.

6.7.4 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.**

6.7.5 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.

Although not required, it is good practice for departments to include a statement of trust monies in their annual report for any trusts they have been appointed to manage on behalf of the Crown. Where reporting of such trust monies is included in departments' annual reports, qualitative information surrounding the trust account activities during the year is encouraged as well as comparative information.[7]

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7 Refer to Audit New Zealand's model financial statements for departments: http://www.auditnz.govt.nz/publications-resources/mfs-under-new-pbe-standards/govt-dept

6.7.6 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 (ie, 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.**

6.7.7 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 section 68 of the Act and pursuant to 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.

6.7.8 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. 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.

6.7.9 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.

6.7.10 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 revenue received by the trust on trust investments, assets, and current balances.

6.8 Contingent liabilities

6.8.1 Introduction

When determining the accounting disclosures for contingent liabilities, the PBE IPSAS 19 definition is the relevant definition.

6.8.2 Types of contingent liabilities

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 (ie, Guaranteed Retirement Income).

6.8.3 Register of contingent assets and liabilities

Each Government Department must maintain a Register of Contingent Assets and 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. As good practice, the registers should also detail how the amount was quantified and justify the amount, and if unquantified, explain why that is. Registers should also detail how the department is managing the risk of the contingent liability and assess the probability of any outflows occurring.

The Chief Executive must determine the responsibility for the management of the Register of Contingent Assets and Contingent Liabilities.

6.8.4 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.

6.8.5 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 appears to the department to be necessary or expedient in the public interest to do so. The Public Finance (Departmental Guarantees and Indemnities) Regulations 2007 specify the types of guarantees or indemnities that a department may give under s65ZE.

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 department has a contingent liability under section 65ZD or 65ZE that exceeds $10 million, 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 tabled in Parliament as soon as practicable.

Further guidance on guarantees and indemnities can be found in the document *"Guidance for issuing and Managing Crown and Departmental Indemnities and Guarantees"*. This guidance document is not for general public release and can be accessed by departments via CFISnet.