Financial reporting update April 2016

1 Revenue from non-exchange transactions

- Significant work went into exchange/non-exchange distinction on transition and we generally wouldn't expect much change in 2016
  - For funding that has conditions that drive the accounting, you will need to regularly review your assessment of those terms. Have there been changes to circumstances which could change the substance of those conditions and when they will be met?
- Assumptions used for measuring revenue at fair value at initial recognition will also need to be regularly reviewed
  - When revenue is first recognised it is measured at its fair value. Where non-collection is a significant issue, the fair value measurement will require assumptions about future collectability. The collectability of fines is an example.
- When you have new funding arrangements or new types of revenue, and they could be material, consider the accounting treatment early.

2 Grant expenditure

- Grants are widespread in the public sector. That term encompasses a wide variety of funding flows from the public sector to individuals, NGOs and the private sector, and also funding flows **within** the public sector. For government departments, the focus is on non-departmental grant expenses.
- In last year's audit of some grant-paying entities we identified that the accounting for grant expenditure may not always be appropriate under the new PBE Standards. The particular concern is the timing of recognition of the expense and liability.
- It is a difficult area and there has been very little – if any – guidance in the standards under the IFRS-regime. Even in the new PBE standards there is still only limited guidance, but the accounting standard on *Revenue from Non-exchange Transactions*, *PBE IPSAS 23*, does give some guidance by "reverse-application".
  - That Standard outlines the matters that should be taken into account when deciding when to recognise **revenue** that is received by way of a grant. By analogy, it can be applied by the entity that is **paying** the grant to determine when the **expense** should be recognised.

- An important issue is whether the funding agreement contains conditions. For the purpose of applying the Standard, “conditions” are term in the agreement that specify how the money is to be used and, if it is not used as specified, then it must be returned. The types of issues that can be encountered and will need to be considered include:

    - Grants with no conditions:

        - Currently, these may have been recognised as they are paid (that is, on a cash-basis or time period basis) even if multi-year. If there are no conditions then perhaps they should be recognised “upfront”.

    - Grants with conditions or payments made upon achieving milestones:

        - In some cases these may have been recognised up-front when the grant application is approved and the approval has been communicated to the recipient. If there are conditions/milestones then perhaps the grants should be recognised as conditions/milestones are achieved.

There can be significant judgement whether the terms of the grant do actually give rise to “conditions” that are sufficiently substantive that they should drive the accounting treatment.

3 New accounting standards

3.1 PBE Standards

3.1.1 Changes for the 2016 financial statements

There have been a number of minor amendments to the PBE Standards, which were actioned in the *2015 Omnibus Amendments to PBE Standards.*

The only one we want to bring to your attention is in respect of the Related Party Standard. Details about the others can be found on the XRB website under Archived Standards:
https://www.xrb.govt.nz/Site/Accounting_Standards/Archived_Standards/current_framework/PBE_Standards.aspx

- **PBE IPSAS 20 Related Party Disclosures**

  The definition of “related party” has been expanded to include entities that provide key management personnel services to the reporting entity. If those services are provided by an entity that is a member of a group, then any other member of that group is a related party of the reporting entity.

  From the Standard, the changes are underlined

  Definitions

  4. The following terms are used in this Standard with the meanings specified:

Related parties include:

(e) Entities, or any member of an economic entity of which such entities are a part, which provide key management personnel services to the reporting entity or to the controlling entity of the reporting entity;

Disclosure—Key Management Personnel

34A. If a public sector entity obtains key management personnel services from another entity (the 'management entity'), the public sector entity shall disclose the amounts paid or payable to the management entity for the provision of key management personnel services. The public sector entity is not required to apply the requirements in paragraphs 34(a) and 34(b) to the compensation paid or payable by the management entity to the management entity's employees or directors.

3.1.2 Exposure drafts on new PBE Standards

The exposure drafts discussed below can be found on the XRB[1] website:

https://www.xrb.govt.nz/Site/Accounting_Standards/Exposure_Drafts/Current_Exposure_Drafts.aspx

- **Service Performance Reporting –** How public benefit entities tell their story

  The new Standard will only apply to Tier 1 and 2 entities. The accounting standard for Tier 3 entities already contains requirements for service performance reporting, but the new standard may provide useful guidance.

  The approach the proposed standard takes is built around reporting outputs outcomes and impacts. The Exposure Draft refers to three dimensions of service performance and puts forward proposals for reporting on all three dimensions. The three dimensions are:

  a What did the entity do? What goods and services (referred to as outputs) did the entity provide during the period?

  b Why did the entity do it: What outcomes did the entity seek to influence? and

  c What impact did the entity have?

  For most entities in the public sector that will fit with the way they report performance

  But the amendments to the Public Finance Act and Crown Entities Act gave some flexibility for performance reporting in terms of measuring what you are intending to achieve, and some entities have moved away from the strict outcomes and impacts approach. The new Standard would require them to move back towards that framework.

[1] External Reporting Board

If that approach doesn't suit the way you need to "tell your story", then tell that to the New Zealand Accounting Standards Board. It doesn't need to be a formal submission – an e-mail will work just as well

Comments are due to the New Zealand Accounting Standards Board[2] by **29 July 2016**. The NZASB proposes to develop non-authoritative guidance, in the form of an Explanatory Guide, and is interested in feedback on the type of guidance that entities consider would be useful.

- **Interests in other entities**

  There are proposed new standards dealing with interests in subsidiaries, associates and joint arrangements. Currently there are three PBE Standards dealing with these matters (PBE IPSASs 6-8), they will be replaced with five new standards:

  - PBE IPSAS 34 Separate Financial Statements;
  - PBE IPSAS 35 Consolidated Financial Statements;
  - PBE IPSAS 36 Investments in Associates and Joint Ventures;
  - PBE IPSAS 37 Joint Arrangements; and
  - PBE IPSAS 38 Disclosure of Interests in Other Entities.

  Overall, the content in the new and old standards is the same, but will be split differently. The table below shows how the content aligns:

The new Standards	**Content**	**The existing Standards**
PBE IPSAS 34 *Separate Financial Statements*	*PBE IPSAS* 34 has the "separate financial statements" part of the current Standard PBE IPSAS 6. • How to account for interests in subsidiaries, associates and joint ventures in the separate (=parent) financial statements • Disclosures when taking the exemption not to not to consolidate.	PBE IPSAS 6 Consolidated and Separate financial statements • Has the elements that will be covered by IPSAS 34 & IPSAS 35
PBE IPSAS 35 *Consolidated Financial Statements*	• Criteria to determine whether or not a group exists. • Consolidation procedures.	

[2] New Zealand Accounting Standards Board is a sub-Board of the External Reporting Board

The new Standards	Content	The existing Standards
PBE IPSAS 36 *Investments in Associates and Joint Ventures*	• Criteria to determine whether an investment is an associate • Equity accounting procedures, including for JV's that are equity-accounted.	PBE IPSAS 7 *Investment in Associates*
PBE IPSAS 37 *Joint Arrangements*	Criteria to determine whether or not an entity has a joint venture/ arrangement, and what type it is • The new Standard has different types of JV/JA, and only two types instead of the current three; • How to account for each type: line-by-line consolidation or equity (*if equity, then go to IPSAS 36*).	PBE IPSAS 8 *Interests in Joint Ventures*
PBE IPSAS 38 *Disclosure of Interests in Other Entities*	Disclosure requirements for interests in: • subsidiaries • associates and joint arrangements (whether "direct into parent-only" or group financial statements); • unconsolidated structured entities.	*There isn't a separate Standard for disclosures in the existing framework. Each of the current standards has the disclosures for the particular type of interest (subsidiary, associate etc.)*

The proposals are relevant for public benefit entities (PBEs) in Tiers 1 and 2. They will also be relevant to Tier 3 PBEs to the extent they have interests in other entities. The proposals are not relevant to Tier 4 PBEs.

The new Standards are based on more recent IPSASs that were released by the IPSASB in January 2016 and have been modified where necessary for the New Zealand environment. Some of the main changes between the existing PBE Standards and the proposals are:

- o A new definition of control, but there is still a need to consider both power and benefits;
- o More guidance for assessing control; and
- o New categories of entities, for example, investment entities and structured entities.

The definition of control may impact previous assessments of control, and therefore whether certain entities should be consolidated or not. However, the impacts are broadly similar to the current criteria.

The new structure, and the new definition of control, in general aligns with the standards in the for-profit sector.

- **Public Sector combinations**

  This Standard will provide guidance on the type of combinations that we commonly encounter in the public sector where entities under common control are merged. The current Standard, *PBE IFRS 3 Business Combinations*, does not apply to a combination of entities under common control.

  The Standard will, in essence, follow the approach that is currently used by applying the modified pooling of interests method of accounting. Under that approach the resulting/remaining entity measures the assets and liabilities that it has taken over at their carrying amounts in the financial statements of the disestablishing entities as of the amalgamation date. This will be subject to consistency of accounting policies between the old and new entities.

  The resulting/remaining entity accounts for the net assets received as an equity injection.

3.2 For-profit sector - new standards

Relevance for Public Benefit Entities: May well see similar a standard for public benefit entities, and perhaps even with a similar effective date

- **Leases (NZ IFRS 16)**

  In essence: all leases accounted for as finance leases.

  For-profit entities will have to apply the new standard for periods beginning on or after 1 January 2019.

  The accounting will be:

Balance Sheet	
Recognition	**All** leases on balance sheet, but with exemptions for: • short term leases [less than 12 months]; • low-value items [e.g. tablets, laptops, phones]
Measurement	• Lease liabilities: measure at the current value of future lease payments. • At initial recognition, value of lease asset = value of lease liability. • Amortisation of lease assets: as for other assets.

Income statement*	
Operating costs	Amortisation of lease assets.
Finance costs	Interest element of lease payments. The ‘principal’ element of the payment is a reduction in the lease liability.
Cash flow statement*	
Operating activities	Interest element of lease payments *[interest payments can be presented within either operating or financing activities]*
Financing activities	Principal

* Under the current Standard, the total amount of the lease payment under an operating lease is expensed. Under the new Standard the lease payment will be split into an interest component, which is expensed, and a principal component, which will be a balance sheet entry.

4 Disclosure initiatives

Recent changes to the accounting standards have reinforced the need for preparers to consider the materiality of disclosures rather than disclose everything referred to in the standards. The standard allows preparers to “reduce the clutter” in financial statements by not reporting information that is not considered material for the readers[3].

But even within the standards there is the opportunity to reduce disclosures. Are you eligible to report under a lower tier?

- For example, if you’re reporting under Tier 1 could you be using the Reduced Disclosures Regime (Tier 2)? Or, if you are reporting under Tier 2, could you move to Tier 3?
- Are you using all the exemptions available? For example, some Tier 2 entities were still including the reconciliation between the statement of cash flows and the surplus/deficit. That isn’t required if you’re reporting under Tier 2.
- But if there is an optional disclosure that is important in the context of your activities, then you should consider including it even though the Standard allows you not to.

If you’ve done all that, do your financial statements include policies and disclosures that really aren’t material?

- Only need to include the information that’s necessary.

[3] OAG report *Improving financial reporting in the public sector* February 2016

- But a **key point** here is that the reporting needs to be better by being smarter; it's not about cutting words from the disclosures that you do need to have.

- And the disclosures that you do have should be worded so that they are easy to understand and adequately explain matters. That may mean having **more** words in some cases.

- For example, an aspect that is often underdone are the disclosures on the assumptions and judgements that underlie the financial statements. But focus on the assumptions and judgements that are key.

  - For example, if your department is capital intensive then put your effort into the property, plant and equipment disclosures. For instance, how have you determined the remaining useful life, and the current condition of the assets when you're estimating the replacement cost?

  - Or, if you have a public-private-partnership there will need to be good disclosure about the significant terms of the arrangement so that the reader can understand the future implications and obligations.

- Some entities are experimenting with combining policies and notes. The idea is that it will help the flow of words and avoid some of the repetition that often occurs when an issue is that was first mentioned in the policies is reintroduced in the note.