Model financial statements: Te Motu District Council – Commentary

Commentary for 30 June 2022 reporting by local authorities

The most currently available model financial statements for Te Motu District Council (the Council) are for the year ended 30 June 2021.

Other than a limited number of disclosure matters discussed below, the 30 June 2021 model financial statements remain relevant for local authority financial statements for the year ended 30 June 2022.

In this commentary, we discuss the following matters:

- revaluations of property, plant, and equipment;
- three waters reform;
- accounting for software as a service (SaaS); and
- commentary and updates to model financial statement disclosures.

Revaluation of property, plant, and equipment

Economic factors – for example, inflation, escalation of costs, and increases in interest rates – could significantly affect fair value assessments and valuations of property, plant, and equipment this year.

Recent data has indicated some significant increases to the values of land and commercial buildings, and to replacement costs that are used in depreciated replacement cost valuations.

Local authorities and their valuers will need to consider these economic factors and the impact of market/cost price movements on the fair value of property, plant, and equipment.

PBE IPSAS 17 *Property, Plant and Equipment* states that "Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the reporting date".

In some instances, this may mean local authorities are required to complete an out-of-cycle full valuation. Where an out-of-cycle valuation is required, in some cases it is possible to book a valuation movement based on indicative movements from indices supported by expert advice. Local authorities needing out-of-cycle valuations of one or more asset classes should discuss this with their Audit Director.

Three waters reform programme

Local authorities affected by the three water reform programme will need to disclose information in their financial statements about the proposed reforms. An example disclosure is provided below:

"**Note xx – Three waters reform programme**

In June 2022, the Government introduced legislation to establish four publicly owned water services entities to take over responsibilities for service delivery and infrastructure from local authorities with effect from 1 July 2024. The impact of these proposed reforms, once legislated, will mean that the Council will no longer deliver three waters services or own the assets required to deliver these services. The Bill is currently before Parliament and as such, the impacts of the proposed reforms are currently unclear. Additional legislation is expected later in 2022 that will provide detail on the transfer of assets and liabilities to the water service entities."

The three waters reform programme disclosure will need to be updated to reflect any changes or developments prior to the finalisation of the annual report. This may include changes to the Government's proposal, or the progress of the Bill through the House.

Accounting for software as a service (SaaS)

Entities can sometimes incur significant costs when implementing cloud computing arrangements. Until recently, there has been no specific guidance on this subject in New Zealand accounting standards.

An agenda decision issued by the IFRS Interpretations Committee (IFRIC) has provided some clarity on the accounting for certain costs in implementing such arrangements under the International Financial Reporting Standards (IFRS).

The IFRIC decision must be applied by for-profit entities. There is no formal interpretation by the International Public Sector Accounting Standards Board. However, we note that PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* says that entities may consider the IFRIC decision when developing their accounting policies for matters not covered by the PBE IPSAS standards. For public benefit entities, the agenda decision can be referred to in determining the accounting treatment because the underlying intangible asset standards are consistent between IFRS and PBE IPSAS.

The key issues are whether such costs should be:

- capitalised as an intangible asset and amortised;
- expensed when incurred; or
- expensed over the term of the SaaS arrangement (including capitalising as a prepaid service if paid upfront).

If a local authority has material SaaS arrangements, it should carefully consider the accounting treatment for these costs when preparing the 30 June 2022 financial statements.

The Treasury has issued guidance on the accounting for SaaS arrangements: [Guidance on Accounting for Software as a Service (SaaS) (treasury.govt.nz)].

Commentary and updates to model financial statement disclosures

The table below notes the updates to those disclosures in the 2021 model financial statements that should be considered by local authorities in preparing their 30 June 2022 financial statements.

The yellow highlight indicates the disclosure concessions available under the reduced disclosure regime (Tier 2).

2021 model section	Discussion
Note 1 Statement of accounting policies – New amendment applied	An amendment to PBE IPSAS 2 *Cash Flow Statements* requires disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. We consider this disclosure is relevant to those Tier 1 local authorities with: • material liabilities with cash flows that are, or will be, presented in the financing activities cash flow section of the statement of cash flows; and • non-cash amounts related to these liabilities that are more than trivial amounts. **Accounting policies section:** ***New amendment applied*** *An amendment to PBE IPSAS 2 Cash Flow Statements requires entities to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. The new information required by this amendment has been disclosed in Note 30D.* **Notes section:** Refer to an illustrative example disclosure after this table.
Note 1 Statement of accounting policies – Standards issued and not yet effective that have been early adopted	For those local authorities that have early adopted PBE IPSAS 41 *Financial Instruments* this year, the 30 June 2021 model financial statements on pages 19 and 81 include illustrative disclosures for the transition to PBE IPSAS 41. There are other disclosures that are affected by the first-time adoption of PBE IPSAS 41. For an indication of the range of affected disclosures, refer to the main updates to the model section on page 6 of the 2021 model financial statements.

<table>
<tr><th>2021 model section</th><th>Discussion</th></tr>
<tr><td>Note 1 Statement of accounting policies – Standards issued and not yet effective, and not early adopted</td><td>
The disclosures about the Amendment to PBE IPSAS 2 and PBE IPSAS 40 PBE Combinations are no longer relevant because they are effective for the 30 June 2022 financial statements.
Disclosures relating to PBE IPSAS 41 will be required for the 30 June 2022 financial statements if a local authority has not yet adopted this standard. We have provided disclosures below for those local authorities that will transition from PBE IFRS 9 and for those that will transition from PBE IPSAS 29.
The disclosure for PBE FRS 48 Service Performance Reporting has been updated below to describe the potential impact of the new standard.
Standards issued and not yet effective, and not early adopted
Standards and amendments, issued but not yet effective that have not been early adopted, and which are relevant to the Council are:
<u>PBE IPSAS 41 Financial Instruments (transitioning from PBE IFRS 9)</u>
PBE IPSAS 41 replaces PBE IFRS 9 Financial Instruments and is effective for the year ending 30 June 2023, with earlier adoption permitted. The Council's initial assessment is there will be little change as a result of adopting the new standard as the requirements are similar to those contained in PBE IFRS 9.
<u>PBE IPSAS 41 Financial Instruments (transitioning from PBE IPSAS 29)</u>
PBE IPSAS 41 Financial Instruments replaces PBE IPSAS 29 Financial Instruments: Recognition and Measurement and is effective for the year ending 30 June 2023, with earlier adoption permitted. The main changes under the standard relevant to the Council are:

New financial asset classification requirements for determining whether an asset is measured at fair value or amortised cost.
A new impairment model for financial assets based on expected losses, which might result in the earlier recognition of impairment losses.
A new hedge accounting model for hedge accounting relationships, should the Council elect to adopt the new model. The Council can elect to continue to apply the PBE IPSAS 29 hedge accounting model on transition to PBE IPSAS 41.

The Council has not yet quantified the impact on the financial statements for the adoption of PBE IPSAS 41.
<u>PBE FRS 48 Service Performance Reporting</u>
PBE FRS 48 replaces the service performance reporting requirements of PBE IPSAS 1 Presentation of Financial Statements and is effective for the year ending 30 June 2023, with earlier adoption permitted. The Council has determined the main impact of the new standard is that additional information will need to be disclosed on those judgements that have the most significant effect on the selection, measurement, aggregation, and presentation of service performance information.
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2021 model section	Discussion
Note 3 Personnel costs	**Update of defined benefit scheme section in Note 3** The defined benefit scheme section in Note 3 should be updated for the actual information as at 31 March 2022 once available from the website of the National Provident Fund.
Note 33 Impact of Covid-19	**Disclosure expectations for Covid-19 impacts** While the risks and uncertainties associated with the Covid-19 pandemic have reduced since the 2020 and 2021 financial statements were prepared, we expect that Councils will continue to disclose information in their 2022 financial statements about the impact that Covid-19 has had on their operations and financial statements during the year, where this is significant. The Covid-19 disclosures included in the 2021 financial statements will need updating to be relevant for the 2022 year.

The following is an illustrative example of a note providing a reconciliation of movements in liabilities arising from financing activities. Where a local authority has a group, both parent and group amounts will need to be presented if different. This disclosure is not required by entities that apply the reduced disclosure regime.

Comparative information is not required when applying the amendment for the first time.

PBE IPSAS 2.55A

30D Reconciliation of movements in liabilities arising from financing activities

The table below provides a reconciliation between the opening and closing balance of liabilities with cash flows that were, or future cash flows that will be, classified as a financing activity in the statement of cash flows.

	Financial guarantees **$000**	**Finance leases** **$000**	**Debentures and other loans** **$000**
Balance at 1 July 2021	**346**	**63**	**27,995**
Cash inflows	0	0	2,600
Cash outflows	0	(28)	(474)
Non-cash changes	28	2	28
Balance at 30 June 2022	**374**	**37**	**30,149**

September 2022

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