

Accounting Policies for the Forecast Financial Statements of the Government for the Budget Economic and Fiscal Update 2020

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The forecast financial statements contained in the published *2020 Budget Economic and Fiscal Update (Budget Update)* are based on the following accounting policies:

Statement of Compliance

These financial statements have been prepared in accordance with the Public Finance Act 1989 and with New Zealand Generally Accepted Accounting Practice (NZ GAAP) as defined in the Financial Reporting Act 2013.

These forecasts have been prepared in accordance with Public Sector PBE Accounting Standards (PBE Standards) – Tier 1. These standards are based on International Public Sector Accounting Standards (IPSAS). The forecast financial statements comply with PBE FRS-42: *Prospective Financial Statements* and NZ GAAP as it relates to prospective financial statements.

For the purposes of these forecast financial statements, the Government reporting entity has been designated as a public benefit entity (PBE). 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.

The use of public resources by the Government is primarily governed by the Public Finance Act 1989, the State Sector Act 1988, the Crown Entities Act 2004 and the State-owned Enterprises Act 1986.

Reporting and Forecast Period

The reporting periods for these forecast financial statements are the years ended 30 June 2020 to 30 June 2024.

The “2020 Previous Budget” figures are the original forecasts to 30 June 2020 as presented in the 2019 *Budget Update* and the “2019 Actual” figures are the audited results reported in the *Financial Statements of the Government of New Zealand for the year ended 30 June 2019*, except where balances have been restated to reflect the adoption of the following accounting standards from 1 July 2019:

- PBE IPSAS 35: *Consolidated Financial Statements*, and
- PBE IPSAS 39: *Employee Benefits* (update of PBE IPSAS 25 *Employee Benefits*).

These two accounting standard changes are described below (under “Basis of preparation”) and in Note 17 of the forecast financial statements contained in the published *Budget Update*.

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 Financial Statements of the Government. Such entities are primarily in the education sector.

Basis of Preparation

These financial statements have been prepared on the basis of historic cost modified by the revaluation of certain assets and liabilities, and prepared on an accrual basis, unless otherwise specified (for example, the Statement of Cash Flows).

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

From 1 July 2019, the Government has adopted PBE IPSAS 35 *Consolidated Financial Statements* and PBE IPSAS 39 *Employee Benefits* and as a result, the relevant accounting changes have been incorporated in these forecast financial statements.

Under PBE IPSAS 35, the New Zealand Superannuation Fund is consolidated as an investment entity. Consequently, any controlling interests the New Zealand Superannuation Fund has invested in are reported on a fair value basis and shown as a single line item *Investments in controlled enterprises* in the statement of financial position, rather than consolidated on the previous line-by-line basis.

PBE IPSAS 39 has two main impacts on the forecast financial statements. It:

- requires a liability to be reported for the obligation to pay Veteran Disability entitlements
- changes aspects of the presentation of the defined benefit scheme- mainly the Government Superannuation Fund (GSF).

Veterans Disability Entitlements

The Veterans Support Act 2014 provides for a number of entitlements for eligible veterans (and their spouses, partners, and dependants) who suffer service-related injuries or illnesses. Previously, these obligations had been classified as social benefits, and were recognised as payments became due. PBE IPSAS 39 clarifies that as these obligations arise due to illness or injury from qualifying operational service, a liability should be recognised from that date (reflecting the lifetime entitlement amounts, discounted to today’s dollars). The accounting policy for Veterans disability entitlements is therefore changing in these forecasts to be the same as for other employee defined benefits with the new liability recognised from 1 July 2018.

Presentation impacts

PBE IPSAS 39 also impacts the way all defined benefits, including the Government Superannuation Fund (GSF) defined benefit pension scheme is presented in the financial statements, with actuarial gains/losses now being presented in the Statement of

Comprehensive Revenue and Expenses (and accumulated in a new revaluation reserve) rather than presented as a gain or loss in the Statement of Financial Performance. The new standard also means the investment return on the scheme's assets above the risk-free rate of return is now classified as actuarial gains and losses in reserves.

The new standard does not affect the way the GSF defined benefit liability is calculated overall, nor is the Crown's total Net Worth affected by the new presentation. From 1 July 2018, cumulative GSF actuarial gains and losses will accumulate in the new revaluation reserve 'Defined Benefit Plan revaluation reserve', rather than in Taxpayers' Funds.

The new accounting treatment in PBE IPSAS 35 and 39 is also applied to the comparative information (2019 Actual and 2020 Previous Budget) presented in the forecast financial statements. For further details of the restatement of these comparatives, refer to Note 17 of the forecast financial statements contained in the published *Budget Update*.

Judgements and Estimations

The preparation of these financial statements requires 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.

These forecasts include budget adjustments for unallocated spending (new decisions) during the year (both operating and capital) and top-down adjustments which reduce the bias for forecast expenditure by departments to reflect maximum spending limits instead of mid-point estimates. 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 these judgements significantly affect the amounts recognised in the forecast financial statements they are described in the notes of the forecast financial statements.

Reporting Entity

The Government reporting entity as defined in section 2(1) of the Public Finance Act 1989 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 of the Government reporting entity" and the description "Financial Statements of the Government" have the same meaning and can be used interchangeably.

Basis of Combination

These financial statements 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
- Christ Church Cathedral Reinstatement Trust
- New Zealand Institute of Skills and Technology
- Venture Capital Fund
- 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 (Mixed ownership model companies) of the Public Finance Act 1989
- Legal entities listed in Schedule 6 (Legal entities created by Treaty of Waitangi settlement Acts) of the Public Finance Act 1989

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, Christ Church Cathedral Reinstatement Trust, City Rail Link Limited 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, except for any controlling interests the New Zealand Superannuation Fund has invested in, which are reported on a fair value basis and shown as a single line item *Investments in controlled enterprises* in the statement of financial position. Transactions and balances between these sub-entities are eliminated on combination. Where necessary, adjustments are made to the financial statements of controlled entities to bring the accounting policies into line with those used by the Government reporting entity.

Other than the New Zealand Institute of Skills and Technology, tertiary education institutions such as universities, are equity-accounted for the reasons explained in the note to the Government's financial statements for the period ended 30 June 2019. 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.

Significant Accounting Policies

The accounting policies set out below will be applied consistently to all periods in the *Budget Update*.

Revenue

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.

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 is measured at the fair value of consideration received. Revenue from the supply of goods is recognised when the significant risks and rewards of ownership have been transferred to the buyer. Revenue from the supply of services is 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.

Interest revenue

Interest revenue is 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.

Dividend revenue

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

Rental revenue

Rental revenue is recognised in the statement of financial performance on a straight-line basis over the term of the lease. Lease incentives granted are recognised evenly over the term of the lease as a reduction in total rental revenue.

Donated or subsidised assets

Where an asset is acquired for nil or nominal consideration, the fair value of the asset received is 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.

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.

Expenses

General

Expenses are recognised in the period to which they relate.

Welfare benefits and entitlements

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

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.

Interest expense

Interest expense is 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.

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.

Foreign currency

Transactions in foreign currencies are 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 are 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 are 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 are 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.

Foreign exchange gains and losses arising from translating monetary items that form part of the net investment in a foreign operation are reported in a translation reserve in net worth and recognised in the statement of comprehensive revenue and expense.

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.

Financial instruments – forecasting policies

For forecast purposes 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) include the write-down to fair value when the loan or receivable is forecast to be issued and where applicable, the revenue from the effective interest unwind.

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

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

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

Derivatives

Only the value of derivatives as at the forecast reference date are forecast to 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 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.

Except in limited circumstances, future derivative activity is not included in forecasts. This is because fair value forecasts of future derivatives are assumed to be 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.

Financial instruments – accounting policies

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.

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 fair value through the operating balance. 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.

Fair value measurement

Fair value is the amount that would be received when an asset is sold or paid on satisfactory settlement of a liability between knowledgeable, willing parties in an arm's length transaction. Generally, transaction price is used as the best estimate for the initial recognition of financial instruments, plus or minus directly attributable transaction costs, unless fair value is evidenced by comparison with other observable current market transactions in the same instrument (ie, without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. Where such evidence exists any profit or loss is accounted for on initial recognition.

Subsequent fair value measurements will be based using the following methods and hierarchy:

1. Quoted Market Price – Financial instruments with quoted prices for identical instruments in active markets (level 1).
2. Valuation Technique Using Observable Inputs – Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets, and financial instruments valued using models where all significant inputs are observable (level 2).
3. Valuation Technique with Significant Non-observable Inputs – Financial instruments valued using models where one or more significant inputs are not observable (level 3).

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 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 determined on an individual basis. Those deemed 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.

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. 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.

Non-derivative financial liabilities

General Principles

Non-derivative financial liabilities are generally subsequently measured at amortised cost. Amortisation and, in the case of monetary items, foreign exchanges 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 (ie, 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.

Financial Guarantee Contracts

Financial guarantee contracts are recognised as a financial liability at the time the guarantee is issued. The liability is initially measured at fair value and subsequently at the higher of:

- the amount determined in accordance with the expected credit loss model under PBE IFRS 9 *Financial Instruments*, and
- the amount initially recognised less, where appropriate, cumulative amortisation of the initial fair value recognised in accordance with PBE IPSAS 9 *Revenue from Exchange Transactions*.

If the guarantee is issued on a commercial basis, the initial fair value is likely to equal the guarantee fee received. If no fee is received, the contract represents the granting of a concessionary guarantee and the fair value is determined using an appropriate valuation technique that provides a reliable measure of fair value.

Where financial guarantees are provided for no fee, an expense is recognised equal to the fair value of the guarantee contract, or where no reliable measure of fair value can be determined, equal to the amount of expected credit loss under PBE IFRS 9 on initial recognition.

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.

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 (eg, 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 (eg, 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.

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.

Property, plant and equipment – forecasting policy

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

Property, plant and equipment – accounting policies

Measurement on initial recognition

Items of PPE 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 PPE. 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, as revenue in the statement of financial performance.

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 of completing and preparing assets for their intended use are expensed rather than capitalised.

Subsequent measurement

Subsequent to initial recognition, classes of PPE are accounted for as set out below.

Revaluations are carried out for a number of classes of PPE 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.

Class of PPE	Accounting policy
Land and buildings	<p>Land and buildings are recorded at fair value and, for buildings, less depreciation accumulated since the assets were last revalued.</p> <p>Land associated with the rail network and state highways is valued using an estimate based on adjacent use, as an approximation to fair value.</p> <p>Valuations undertaken in accordance with standards issued by the New Zealand Property Institute are used where applicable.</p> <p>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.</p> <p>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.</p>
Specialist military equipment	<p>Specialist military equipment is recorded on a depreciated replacement cost basis less depreciation accumulated since the assets were last revalued.</p> <p>Valuations are obtained through specialist assessment by New Zealand Defence Force advisers, and the basis for the valuation is confirmed as appropriate by an independent valuer.</p>
State highways	<p>State highways are recorded on a depreciated replacement cost basis less depreciation accumulated since the assets were last revalued.</p>
Rail network	<p>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.</p>
Aircraft	<p>Aircraft (excluding specialised military equipment) are recorded at fair value less depreciation accumulated since the assets were last revalued.</p>

Class of PPE	Accounting policy
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 less subsequent impairment losses. 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.

Revaluation

Classes of PPE that are revalued are 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.

When an item of property, plant and equipment is revalued, any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset.

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.

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 PPE are as follows:

Class of PPE	Estimated useful lives
Buildings	25 to 150 years
Specialist military equipment (SME)	5 to 55 years
<i>State highways:</i>	
Pavement (surfacing)	9 years
Pavement (other)	50 years
Bridges	90 to 100 years
<i>Rail network:</i>	
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.

Impairment

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, unless the asset is carried at a revalued amount in which case any impairment loss is treated as a revaluation decrease.

Disposal

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.

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 are measured at amortised cost.

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 certain Tertiary Education Institutions, such as universities. 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.

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 are 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 managed for harvesting into agricultural produce, or being transformed into additional biological assets are reported as other assets. Other biological assets are recorded as other property, plant and equipment in accordance with the policies for property, plant and equipment.

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.

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 held for sale, or disposal groups, are recorded at the lower of their carrying amount and fair value less costs to sell.

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 are 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.

Employee benefits

Pension and other similar long-term benefit 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, and similar long-term benefits, such as entitlements for eligible veterans who suffer service-related injuries or illnesses, are recorded at the latest actuarial value of the Crown liability. All movements in the liability, except for actuarial gains and losses, are recognised in the statement of financial performance in the period in which they occur. Actuarial gains and losses are recognised in the statement of comprehensive revenue and expenses in the period in which they occur and accumulated over time in the relevant defined benefit retirement plan or long-term benefit revaluation reserve.

Other employee entitlements

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

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.

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.

Reinsurance

Premiums paid to reinsurers are recognised as reinsurance expense in the statement of financial performance. Premiums are measured 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.

Reinsurance and other recoveries receivable

Reinsurance and other recoveries receivable on paid claims and outstanding claims, 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.

Leases

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.

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.

Other liabilities and provisions

Other liabilities and provisions are 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.

Contingent liabilities and contingent assets

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.

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.
- Lease commitments: non-cancellable operating leases with a lease term exceeding one year.

Cancellable commitments that have penalty or exit costs explicit in the agreement on exercising the option to cancel are reported 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.

Comparatives

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

Comparatives referred to as “2020 Previous Budget” were forecasts published in the 2019 *Budget Economic and Fiscal Update*. Comparatives referred to as “2019 Actual” were published in the *Financial Statements of the Government of New Zealand for the year ended 30 June 2019*. Both sets of comparatives have been restated for two new accounting standards, PBE IPSAS 35 and PBE IPSAS 39, adopted from 1 July 2019. For further details of these accounting changes and restatement of comparatives, refer to “Basis of preparation” above and Note 17 of the forecast financial statements contained in the published *Budget Update*.

Segment analysis

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

- **Core Crown:** This group, which includes Ministers, government departments, Offices of Parliament, 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.
- **Crown entities:** This group includes entities governed by the Crown Entities Act 2004. These entities have separate legal form and specified governance frameworks (including the degree to which each Crown entity is required to give effect to, or be independent of, government policy).
- **State-owned Enterprises:** This group includes entities governed by the State-owned Enterprises Act 1986, and (for the purposes of these statements) also includes Air New Zealand, Mighty River Power (now Mercury NZ Limited), Meridian Energy and Genesis Energy. This group represents entities that undertake commercial activity.

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 Organisation for Economic Co-operation and Development (OECD).