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Submitted to: submissions@xrb.govt.nz

Proposed Improvements to the Tier 3 and Tier 4 (Public Sector) Standards – Consultation Document

We appreciate the opportunity to provide comments to the New Zealand Accounting Standards Board on the consultation document *Proposed Improvements to the Tier 3 and Tier 4 (Public Sector) Standards*.

There is a diverse range of public benefit entities in the public sector that apply the Tier 3 and 4 simple format reporting standards. Consequently, the nature of activities and associated revenues, expenses, and assets varies across these entities. Entities that apply the current Tier 3 standard include those with the following activities: tourism, regional economic development, provision of local amenities (e.g museums, galleries, pools, halls, and theatres), fundraising, health and education services.

Therefore, it is important that the standards cater for these diverse range of entities.

We are in agreement with most of the proposed changes to the Tiers 3 and 4 standards and consider that they will result in more appropriate and mainly clearer reporting requirements for Tier 3 and 4 public sector entities. However, there are some changes to the standards we disagree with, or where further work is required to ensure the changes are clear and fit for purpose.

We have outlined these matters in our responses to the consultation questions that are attached.

If you would like to discuss our comments, please phone me on 021 222 6107 or email me at robert.cox@auditnz.parliament.nz or Brett Story on 021 222 6247 or at brett.story@auditnz.parliament.nz.

Yours sincerely



Robert Cox
Director and Head of Accounting

Our responses to the Tier 3 consultation questions:

1. Do you agree with the proposed amendments relating to service performance reporting?

Yes, we are comfortable with the proposed amendments.

2. Do you agree with proposal to include requirements for the revaluation of property, plant and equipment within the Tier 3 (PS) Standard, rather than require an entity to opt-up Tier 2?

Yes, we are in broad agreement with the inclusion of the revaluation requirements within the Tier 3 standard.

We question whether the requirements in paragraph A117.1 may be too onerous for Tier 3 entities. In periods where property values are moving rapidly, this requirement has required some Tier 1 and 2 public sector entities to perform valuations of some of their asset classes very regularly (e.g annually or every 2 years). This can be a significant expense for a small entity. It is also onerous for the reporting entity to obtain annual evidence to demonstrate to their auditor that there has not been a material movement in value. An alternative approach to A117.1 may be to allow Tier 3 entities to set a regular valuation cycle, such as 3 yearly.

3. Do you agree with the proposal to require revaluation movements on property, plant and equipment to be recognised directly in accumulated funds through a revaluation reserve?

Yes, we agree with this proposal.

4. Do you agree with the proposal that investment property should be accounted for in the same manner as property, plant and equipment?

We note there is an alternative view that the revaluation movements for investment property be recorded in the statement of financial performance, which would be consistent with the Tier 2 standard. Putting investment property revaluation movements in the statement of financial performance gives useful information about the results of the investment decisions and would be consistent with the proposed treatment of publicly traded financial investments.

We note however having a single revaluation model applying to both PPE and investment property is simpler.

We don't have a strong view whether the revaluation movements are recognised in the statement of financial performance or directly in accumulated funds.

Other than this observation, we agree with the proposals.

5. Do you agree with the proposal to allow publicly traded financial investments to be measured at market value?

Yes, we agree with this proposal.

6. Do you agree with the proposal to require changes in the market value of investments to be recognised as revenue or expenses in the statement of financial performance?

Yes, we agree with this proposal.

7. Do you agree with the proposals to amend the required revenue and expense categories?

No, we do not fully support the changes to the required revenue and expense categories.

Insufficient flexibility with the categories

In our view, it is essential that the requirements for the statement of financial performance for Tier 3 public sector entities are sufficiently flexible to suit their varied activities. As noted in our introductory comments of our submission, there is wide range of public sector entities applying the Tier 3 standard with diverse transactions. It is important that these entities have sufficient flexibility in disaggregating revenue and expenses in the statement of financial performance to enable presentation of information that is useful to the users of their financial statements. We do not support mandating Tier 3 public sector entities to use specific pre-set line items in this statement, as this may prevent them presenting their financial information in a meaningful way to their stakeholders. We consider flexibility to suit individual needs is more important than forcing consistency of revenue and expense categories across Tier 3 public sector entities.

We disagree that the categories listed in paragraphs A56 and A74 be the only categories that can be used on the face of the statement of financial performance. Under the proposals, there is no flexibility to add further categories to those listed or disaggregate them. In our view, this is a retrograde step from the existing standard that permits this (paragraph A61). The ability to amend the description of the listed categories is not sufficient to address our concerns.

Revenue from commercial activities, and related expenses

We disagree with a category for “revenue from commercial activities”.

The proposals in paragraph A57.2 discuss commercial activities to include the sale of goods or services with an intention to derive a surplus and which do not in themselves contribute to the achievement of the entity’s stated purposes.

It will be rare that Tier 3 public sector entities will engage in “commercial” activities or sales with an intent to derive a surplus. In most cases, any sale of goods and services (such as fees for health or education services, burial fees, facility hireage or entrance fees,) will be priced on a cost recovery basis (or subsidised from other revenue) with no intent to make a profit.

We recommend amending this category to be “sales of goods and services”, which would include the sale of all goods and services not included in the other categories.

We also disagree with a category in paragraph A74(d) for “expenses related to commercial activities” for the same reasons as explained above for revenue. We recommend this category be deleted.

Employee related expenses descriptors

We recommend that the “Employee remuneration” and “Other employee costs” categories be combined into a single employee costs category. It could be unduly complex for Tier 3 entities to disaggregate these costs as it can be unclear what costs belong in which category.

Other expenses

Paragraph A79 of the current standard sets out that other expenses may be further disaggregated, in the statement of financial performance, such as depreciation and fees paid to the governing body. The exposure draft proposes that this paragraph be deleted.

We are concerned there is no longer comment in the standard about disclosing fees paid to members of the governing body. We recommend that the standard require this information to be disclosed in the interest of public accountability.

Furthermore, if the standard continues down the path of mandating categories of expenditure on the face of the statement of financial performance, then we consider depreciation expense should be disclosed on the face of the statement of financial performance.

8. Do you agree with the proposals to amend the revenue recognition requirements for grant, donation, and bequest funding?

We provide comments below on general revenue recognition matters.

Comments on the accrual principle

The principle in paragraph A64 is to record revenue upon the occurrence of a recognition event, which is when there is a legal right to receive cash now or in the future i.e on an accrual basis. Use of the accrual principle for revenue recognition is consistent with the Tier 3 basis of preparation in paragraph A177 which states that "All transactions are reported using the accrual basis of accounting".

Some of the examples in table 1 are not consistent with this principle as they state revenue is recognised on receipt, or when funding or cash is received. For example, this is the case for general funding from government and grants from non-government organisations. This implies cash accounting.

Our view is the default accounting for revenue, including all the examples included in table, should be accruals based as the Tier 3 standard is an accruals standard.

Detailed comments on table 1 in paragraph A64

We have a number of concerns with the revised table 1, which requires significant updating before it is fit for purpose.

1. Funding from government service delivery grants/contracts
 - Funding linked to the delivery of goods or services: The "when to record" column refers to accounting for revenue in accordance with the "revenue from providing goods or services" category. There is no such category in the table. We recommend the "when to record" and "comments" columns be updated to include the text in the "Revenue from the provision of services" category.
 - Revenue from the provision of services (including fees and charges related to services delivered across the year): This category is not needed as it creates duplication with the "Funding linked to the delivery of goods or services" category. The difference between these 2 categories is unclear.

2. Funding from non-government service grants/contracts
 - The explanation of the accounting requirements for funding from non-government and government service grants/contracts is different . They should be the same. We recommend the requirements for the two sources of funding be combined for consistency and to remove duplication.
 - Other fees and charges category: The guidance needs to be clearer on “on-going benefits” for registration fees. It is unclear from the current wording whether it is the entity providing on-going benefits to the registrant that is the determining factor for revenue recognition or whether it is the registrant receiving on-going benefits from the registration. We would expect the key determinant for revenue recognition is whether the registry body has an obligation to provide on-going benefits to the applicant.
3. Donations, koha, bequests and other fundraising revenue from the public or non-government organisations: We consider it unnecessary for this category to refer to “public or non-government organisations”. Accounting for these types of revenue items received from a government entity should also be accounted for under this category.
4. General funding from government and grants from non-government organisations
 - There is no accounting guidance for funding received from government that has expectations over use. We consider this new accounting concept is also needed for grants from government entities.
 - Government funding refers to recording revenue when “funding is received”, compared to grants from non-government organisations when “cash received”. The same terminology needs to be used. This terminology again suggests cash accounting rather than accrual accounting.
 - We recommend the requirements for general government and non-government grants be combined for consistency and to remove duplication.
5. Revenue from commercial activities:
 - For the same reasons as our response in question 7 above, we disagree with a separate revenue category for commercial activities. A general sale of goods and service category is needed for all sales that are not included in the funding from service delivery grants/contracts categories.
 - There needs to be guidance on the accounting for the provision of services. The “Revenue from the provision of services” guidance in the “Funding from government service delivery grants/contracts” category should be copied to this section of the table.

Paragraphs A64.1 to A67

Insignificant donations, grants and bequests are recorded as revenue immediately, including those with expectations over use.

We note the standard is unclear on how you assess whether these items are significant or insignificant. For example, an entity may have many insignificant donations, grants and bequests with expectations over use, but they are significant in the aggregate. In this case, how should the individually insignificant items be accounted for?

We welcome clarity in making this significance judgement when these items are insignificant individually, but significant in the aggregate.

Paragraph A67.4

We do not consider a virtual meeting for which there is a recording as satisfactory for evidencing a documented agreement. It may be impracticable for entities and auditors to transfer these large electronic files via e-mail, and significant time could be spent locating the discussed agreement within the recording file. We consider an e-mail to be the minimum acceptable evidence for a documented agreement and it should not be onerous to follow up a meeting with an e-mail to confirm the decisions or agreement made.

Section 10: Example 1

The difference in the revenue recognition points for scenarios 2 and 3 are unclear. In both scenarios, the Fish and Game Council and the Registration Board are providing a right to the applicant but the entities are not required to provide any additional services to the applicant beyond the issuance of the license/registration. Based on the scenario information provided and guidance in the standard, we would expect the revenue for the Fish and Game Council to be recognised up front and not spread over the license period.

We consider the rationale for the accounting explained in the 2 examples are deficient as they do not explain why the accounting is different.

Additionally, Scenario 3 says revenue is accounted for when the fees are received, which implies when the cash is received. This is not consistent with paragraph A64 where other fees and charges are recorded as revenue when the fee is due to be received.

9. Do you agree with the proposals to require an entity to provide enhanced note disclosure that explains the purpose for which accumulated funds are held?

No, we do not agree with the new disclosure expectations included in paragraphs A198.1 and A198.2.

We note that this disclosure may provide useful information in some circumstances. However, as a matter of principle, we disagree with Tier 3 public sector entities having more onerous reporting requirements than Tier 2 public sector entities.

This disclosure is similar to the capital management disclosures of paragraphs 148A to 148C of PBE IPSAS 1 *Presentation of Financial Statements*. However, Tier 2 entities are not required to disclose this information due to there being a disclosure concession.

10. Do you agree with the proposals to remove the requirements related to restricted reserves?

Yes, we agree with this proposal.

11. Do you agree with the proposed accounting for items of other comprehensive revenue and expense?

Yes, we agree with this proposal.

12. Do you have any comments on the new appendix C?

We have no further comments.

13. Do you agree with the proposed amendments to Section 3 entity information?

We do not support a Tier 3 public sector entity that does not produce a statement of service performance having to disclose information on the significant activities it has undertaken during the financial year to achieve its objectives (paragraph A40(b)). This is requiring information to be disclosed that a Tier 2 public sector entity is not required to disclose (if it does not prepare a statement of service performance).

The most similar disclosure requirement we could find in the Tier 1 and 2 standards is PBE IPSAS 1.150(b) which requires a description of the entity's operations and principal activities. However, Tier 2 entities are not required to disclose this information due to there being a disclosure concession.

14. Do you agree with the proposed amendments to the statement of cash flows?

We agree there should be some consistency between the operating cash flow categories and the revenue and expense categories in the statement of financial performance.

However, we do not fully agree with the categories for the cash flows from operating activities. In particular, we do not agree with the reference to commercial activities. We consider there should be an explicit category for government grants received. There could also be a category for interest paid.

15. Do you agree with the proposed amendments to the definition of cash?

We note there is an alternative view that this change will unnecessarily complicate the preparation of the statement of cash flows for those entities that are not part of a group and have had term deposits during the financial year with differing durations.

We don't have a strong view either way on the proposed cash definition amendment.

16. Do you agree with the proposed effective date of 1 April 2024, with early adopted permitted?

Yes, we agree with the proposed effective date. This should provide entities with sufficient time to prepare for the amendments.

17. Do you have any other comments on the proposals to amend the reporting requirements for Tier 3 public sector entities?

Operating commitment disclosures

Our strong view is the scope of the commitment disclosures of paragraph A200 needs reducing to align with those required by the Tier 2 requirements. At present, the Tier 3 standard requires commitment disclosures for all significant operating commitments. This is significantly wider and more onerous than the Tier 1 and 2 operating commitment disclosure requirements, which generally only apply to operating leases.

Related party transaction disclosures

Our preference would be for all significant transactions with Board members and their related entities, whether on normal terms and conditions or not, to be disclosed as related party transactions across all reporting tiers. This would align the public sector requirements in this regard with the requirements for not-for-profits.

Notwithstanding the above we find the current proposals unclear. To provide further clarity on the disclosure expectations for related party transactions, we recommend the second sentence of paragraph A204 that appears to limit related party transactions to those not under normal terms and conditions be a separate paragraph to give it more prominence.

Our responses to the Tier 4 (PS) consultation questions:

1. Do you agree with the proposed simplifications to the Tier 4 (PS) Standard?

Other than for the specific matters we comment on below, we agree with the proposed simplifications to the Tier 4 (PS) Standard.

2. Do you agree with the proposal to reduce reporting requirements for small Tier 4 public sector entities?

Yes, we agree with this proposal.

3. Are there any proposed reporting concessions for small Tier 4 public sector entities you do not support?

We agree with the proposed reporting concessions for small Tier 4 public sector entities.

4. Are there any other reporting concessions for small Tier 4 public sector entities that should be considered?

No.

5. Do you agree with the proposed amendments to the service performance reporting requirements?

Yes, we agree with the proposed amendments.

6. Do you agree with the proposals to amend the required cash received and paid categories?

No, we do not support the changes to the requirements for the statement of receipts and payments. In our view, it is essential that the requirements for the statement of receipts and payments for Tier 4 public sector entities are sufficiently flexible to suit their varied activities. We do not support mandating Tier 4 public sector entities to use specific pre-set line items in this statement, as this may prevent them presenting their financial information in a meaningful way to their stakeholders. We consider flexibility to suit individual needs is more important than forcing consistency across Tier 4 public sector entities.

We recommend that the following paragraph in the previous version of the Tier 4 public sector standard be reinstated:

“A41. Additional line items, headings and subtotals may be presented in the statement of receipts and payments when this will help users to understand the entity’s financial performance.”

We support the inclusion of a suggested format for the statement of cash received and cash paid. However, we discuss below our concerns with some of the proposed categories, and we recommend some areas for improvement.

Commercial activities

We disagree with the definition of “sale of goods or services” in the proposed revised Tier 4 public sector standard.

The Tier 4 standard defines “sale of goods or services” as

“Cash received (or paid) from the sale of goods or services relate to transactions arising from trading activities, where goods or services are sold on commercial terms for the primary purpose of generating a profit. The profits earned are then used to fund the entity’s service delivery objectives.”

We consider that most sales of goods or services by Tier 4 public sector entities will not meet this definition and will therefore unhelpfully need to be put into another category.

It will be rare that Tier 4 public sector entities will engage in “commercial” activities or sales with an intent to make a profit. In most cases, any sale of goods and services (such as cemetery plot sales, burial services, hall hire) will be priced on a cost recovery basis with no intent to make a profit.

We therefore disagree with the sales of goods and services category being limited to sales from commercial activities. We also recommend deleting “commercial activities” in the descriptor of the sales of goods or services category and similarly in the costs related to sale of goods or services category.

Categories for cash paid for operating activities

We recommend that the “Employee remuneration” and “Other employee costs” categories be combined into a single employee costs category. It could be unduly complex for Tier 4 entities to disaggregate these costs as it can be unclear what costs belong in which category.

Cash received from other activities

We recommend the category “Advance of loans and borrowings” be amended to “Receipt of loans and borrowings”.

7. Do you agree with the proposed effective date of 1 April 2024, with early adoption permitted?

Yes.

8. Do you have any other comments on the proposed improvements to the Tier 4 (PS) Standard?

Related party transactions

Our preference would be for all significant transactions with Board members and their related entities, whether on normal terms and conditions or not, to be disclosed as related party transactions across all reporting tiers. This would align the public sector requirements in this regard with the requirements for not-for-profits.

We find the proposed standard unclear about what related party transactions are required to be disclosed. The suggestion from the second sentence of paragraph 89 is that only transactions not on “normal terms and conditions” need disclosure. This would align the related party disclosure requirements in Tier 4 with those of Tier 1 and 2 public sector entities.

However, the example in paragraph 93(a) on sale of asset to a spouse of a Board member has nothing in its facts to suggest that it is not on normal terms and conditions.

It is important that the Tier 4 public sector standard is clear in its disclosure expectations for related party transactions. Therefore, we consider either paragraph 89 or example 93(a) require amendment.

Should vs. shall

The standard often refers to “should” when outlining a requirement. The previous standard referred to “shall”. For example, in paragraph 28, “Comparative information for the previous financial year should be included for each balance.....”.

It is unclear if this change is intended to provide entities with discretion in applying the relevant paragraph.

We prefer the use of the term “shall” to ensure the standard’s expectation is clear, and to be consistent with the use of this term in the standards for Tier 1 to Tier 3 public sector entities.