



Level 2
119 Ghuznee Street
P O Box 9744
Wellington 6141
New Zealand

info@nzonair.govt.nz
www.nzonair.govt.nz

Tel: 04 382 9524
Fax: 04 382 9546

17 November 2017

New Zealand Accounting Standards Board
submissions@xrb.govt.nz

Tenā koutou

**BROADCASTING COMMISSION (NZ ON AIR) SUBMISSION:
IPSASB Consultation Paper Accounting for Revenue and Non-Exchange Expenses**

The Broadcasting Commission (NZ On Air) is pleased to submit its comments on the International Public Sector Accounting Standards Board's (IPSASB's) Consultation Paper: Accounting for Revenue and Non-Exchange Expenses.

The particular focus of this submission is on the proposed accounting treatment for non-exchange expenses. We are pleased to see this area, previously not explicitly covered in the Public Sector Accounting Standards, clarified. We have some concerns about whether, under the proposed treatment, some public sector financial statements, including NZ On Air's, will present a faithful representation of the effects of transactions, other events and conditions that achieve a fair and meaningful presentation for the users.

We are broadly in agreement with the Public Sector Performance Obligation Approach (PSPOA) proposed in the Consultation Paper. The main focus of this submission is on the definition and application of "performance obligation" with regard to the point of recognising an expense, the need for guidance which reflects the nature of the underlying arrangements and normal practice rather than taking arrangements and contracts at face value, and achieving an approach which provides meaningful information for users.

In preparing this submission, we have consulted with Te Māngai Pāho and the New Zealand Film Commission. We share common concerns about the continuing ability to present financial statements which are meaningful, useful to our users and reflect the underlying reality of our funding expenditure. Many of our interested stakeholders are the same, and comparability both between years and between entities is important. Our financial statements only provide a true reflection of funding expenditure and the use of resources when the expense is recognised on approval rather than based on administrative staging of payments over time, which if taken as the recognition point for the expense, artificially distorts the underlying financial performance and position.

Background

The Broadcasting Commission (NZ On Air) is an autonomous Crown entity under the Crown Entities Act 2004. Our primary job, defined by the Broadcasting Act 1989, is to "reflect and develop New Zealand

Connecting and reflecting our nation



identity and culture". We do this by funding different types of New Zealand media content for mainstream and specially targeted audiences to enjoy.

We are driven by public media principles, which include enriching the New Zealand cultural experience, improving diversity of media content in many forms, ensuring content is accessible, strengthening community life, and promoting informed debate.

We achieve this through contestable funding schemes, resulting in investment (funding) of over \$127 million each year in diverse content and services for audiences. This is a unique model in the world and gives great flexibility to connect audiences with content, no matter where and how they want to enjoy it.

NZ On Air's main revenue source is Crown revenue (98% of total revenue) through the Arts, Culture and Heritage annual appropriation "Public Broadcasting Services". This is supplemented by a small amount of other revenue, including interest on term deposits and NZ On Air's share of revenue from sales of funded programmes.

NZ On Air's main expense is the funding approved each year (over 97% of expenditure). It is non-exchange expenditure as the funded content is not delivered to NZ On Air but rather to the platform for airing, NZ On Air has no input or editorial rights once funding has been approved, and NZ On Air does not own the funded content.

We report annually on our financial and non-financial achievements. The readers of our annual report include our Board of Directors, Parliament, industry commentators (including journalists), entities receiving or hoping to receive funding, and public media researchers, both in New Zealand and overseas.

NZ On Air's primary objective is to provide services to the New Zealand public and does not operate to make a financial return. NZ On Air has therefore designated itself as a public benefit entity (PBE) and reports under Tier 1 of the PBE accounting standards.

We account for funding expenditure in the statement of comprehensive revenue and expense when the Board has approved the funding, sometimes subject to certain conditions to be cleared before formal contracting. This results in the end of year statements broadly reflecting the level of funding approved in the year compared with the Government appropriation. This information is supported by detailed funding schedules of the projects to which funding has been awarded during the year.

NZ On Air's focus is on presenting financial statements compliant with applicable accounting standards and which meet the needs of our users. Key to achieving this is reflecting funding decisions in the financial statements in a way that can be readily understood by and is meaningful to the users.

Meeting the needs of our users

NZ On Air has a well-established accounting policy for funding expenditure. An extract from our accounting policies is attached in Appendix One.

The resulting financial statements provide information which allows our users to make informed assessments and evaluate how NZ On Air has used its resources. User focus is mainly on the statement of comprehensive revenue and expense, in particular the level of funding approved in the reporting period compared with the level of Crown revenue received. Users give consideration to whether NZ On Air is maintaining levels of funding, how these compare with the annual appropriation (Crown funding) received, how these compare with the budget set by the Board in the annual Statement of Performance

Connecting and reflecting our nation



Expectations, published before the start of each financial year, and how these compare with previous years.

In setting and monitoring the annual budget, the Board's focus is likewise on the amount of funding approved compared with the budget set at the start of the year, the remaining budget available for funding and how the funding approved to date achieves NZ On Air's public service objectives.

Equity levels are also of interest to the users. As a Crown-funded organisation not operating to make a financial return and with no borrowings, NZ On Air has no need to maintain significant levels of reserves. The annual budget is usually based on a close-to break even position in order to make maximum possible funding available to applicants to achieve our objectives.

Accounting considerations

To date there has been no clear accounting standard on non-exchange expenses and a lack of clarity about defining and interpreting performance obligations. We note that the Consultation Paper takes a relatively prescriptive approach to what constitutes a performance obligation. However, this does not allow for an entity to reflect the underlying nature of its contracts and transactions, the nature and purpose of the funding, and established practice. Nor does it consider the purpose of the financial statements in the public sector in providing information to the users which is meaningful. Interpreting performance obligations therefore cannot be considered uniform or taken at face value.

NZ On Air's funding expenditure is non-exchange and is recognised as expenditure when:

- (a) The funding has been approved by the Board;
- (b) The funding recipient has been advised;
- (c) There are no substantive contractual conditions for the funding recipients to fulfil; and
- (d) It is probable (more likely than not) that the funded proposal will be completed.

The main substantive contractual condition that means a funding commitment cannot be recorded as expenditure is where the Board approval is subject to confirmation of third party funding, and that funding is not in place.

The underlying contract between NZ On Air and the funding recipient generally includes staged payments which are not tied to specified time periods. These are for administrative purposes to manage the cash flows to funding recipients. NZ On Air does not consider these to be substantive conditions in terms of our accounting policy and therefore they are not considered to be performance obligations. The performance obligation is at the point funding has been approved and substantive conditions (of the nature noted above) have been cleared. At this point both the expense and liability are recognised.

Once funding is approved, applicants have a valid expectation that they will receive the approved funding and work commences on the funded project. As in excess of 99% of funded projects are completed, we expect that payment of the approved funding cannot be avoided.

Once approved with substantive conditions cleared (if any), NZ On Air considers that the resources required for the approved funding have been allocated and are no longer available to direct or allocate for any other purpose. In addition, the approved funding contributes to fulfilling our stated objective against the appropriation received for that financial year. Hence the expense should also be recognised.

The effect of our accounting policy and the recognition point for the funding expense is that the statement of comprehensive revenue and expense generally reflects funding approved in the reporting period. Users of the financial statements can see the extent to which NZ On Air has used/allocated the funds it has available for applicants in the period and to achieve its objectives.

In the current environment, applications for available funds are significantly oversubscribed, with a high level of quality applications being declined. Questions are (rightly) raised by applicants, Parliament and the media when available funding has not been, or appears not to have been, fully utilised.

Our aim is to achieve compliant financial statements which present useful and informative information to our readers, and which is also consistent and comparable with previous periods and similar entities in our sector. It is neither meaningful nor useful to report based on when payment stage claims are made as the resources allocated are already no longer available to NZ On Air for any other purpose.

Recognising the expense taking on a strict interpretation of performance obligations based on contractual payment stages would require extensive explanations and reconciliations in the financial statements to explain the underlying position of interest to the user. As well as being confusing to users, it implies a level of obfuscation in our reporting.

A worked example is set out below:

Funding of \$4.5m is approved by the Board in March. With no conditions to fulfil before the project can proceed to contract, the entries would be:

Scenario One: Current accounting policy and interpretation of performance obligations

On approval of funding by the Board:

Dr Funding expense	\$4.5m	
Cr Funding liability		\$4.5m

One payment of \$950,000 is made before year end:

Dr Funding liability	\$950,000	
Cr Bank		\$950,000

The financial statements show an expense of \$4.5m and a funding liability of \$3.55m at balance date.

Users would see that \$4.5m has been approved against the Crown revenue for the year.

Scenario Two: Applying a strict interpretation of performance obligations

On approval of funding by the Board

Dr Funding asset	\$4.5m	
Cr Funding liability		\$4.5m

As payments are made (one payment of \$950,000 is made before year end):

Dr Funding expense	\$950,000	
Cr Funding Asset		\$950,000
Dr Funding Liability	\$950,000	
Cr Bank		\$950,000

The financial statements show an expense of \$950,000, a funding liability of \$3.55m and a funding asset of \$3.55m.

Users would see that \$950,000 has been approved against the Crown revenue for the year and \$3.55m appears to be unallocated, potentially available for funding other projects.

Scenario Two does not present useful information to the users and is potentially misleading. Whilst disclosures would be added to explain the underlying situation, many of our readers do not look beyond the face of the financial statements to notes and explanatory information.

Conclusion

The primary objective of most public sector entities is to deliver services to the public. As a Crown entity, this is NZ On Air's goal, achieved through its funding activities. For decision-making and accountability purposes, users need information on how the resources provided by government have been applied as well as information on the resources available for future use and changes in the entity's ability to provide services (i.e. funding) compared with the previous period and budget. This information is provided through the annual statements of financial position, financial performance and cash flows, together with non-financial performance information.

The focus of users of core public sector financial statements is different to commercial entities. In particular it is on whether the resources provided by the government of the day have been used for their stated purpose. Enabling presentation of this information in a meaningful and informative way should be the focus of the underlying accounting policies. To that end we request that careful consideration be given by the IPSASB to the interpretation of performance obligations and the resulting impact on fair presentation of the underlying transaction.

Any queries about this submission should be directed to our Head of Corporate Services, Clare Helm (clare@nzonair.govt.nz).

Yours sincerely,



Caren Rangi
Chair – Audit and Risk Committee

Appendices

Appendix One: Accounting policies extract (30 June 2017 Annual Report)

Appendix Two: Financial information

- 2.1 Summary of contract expenditure in 2016/17
- 2.2 Statement of comprehensive revenue and expense, year ended 30 June 2017
- 2.3 Statement of financial position as at 30 June 2017

APPENDIX ONE: Accounting policies extract (30 June 2017 Annual Report)

Funding expenditure

Funding expenditure is discretionary funding where NZ On Air has no obligations to award funding on receipt of the funding application. It is recognised as expenditure when:

- (a) The funding has been approved by the Board;
- (b) The funding recipient has been advised;
- (c) There are no substantive contractual conditions for the funding recipient to fulfil; and
- (d) It is probable (more likely than not) that the funded proposal will be completed.

Critical judgements in applying this accounting policy

Although from time to time an approved project with no substantive conditions to fulfil does not go ahead, such projects are rare. Based on experience we judge it is probable that all approved commitments at 30 June without substantive contractual conditions to fulfil will be completed.

The main substantive condition that means a funding commitment cannot be recorded as expenditure is where the Board approval is subject to further confirmation of third party funding and that funding is not in place at balance date.

Funding liabilities

We recognise a liability for funding expenditure when the following conditions have been met:

- (a) The expenditure has been formally approved
- (b) The funding recipient has been advised
- (c) There are no substantive contractual conditions for the funding recipient to fulfil
- (d) It is probable (more likely than not) that the funded proposal will be completed and that our obligation will crystallise.

At 30 June funding liabilities in the statement of financial position include both contracted liabilities and liabilities that are uncontracted but have no substantive contractual conditions unfulfilled. The amount recorded for the uncontracted liabilities is the amount approved by the Board.

At 30 June therefore, the funding liabilities in the statement of financial position include both contracted liabilities and liabilities that are uncontracted, but have no substantive contractual conditions unfulfilled. The amount recorded for the uncontracted liabilities is the amount approved by the Board.

APPENDIX TWO: Financial information

2.1 Summary of contract expenditure in 2016/17

Funding type and Characteristics	\$	%	Liability at 30/6/17 \$	Liability at 30/6/16 \$
<u>National TV</u> Primarily TV productions and development funding. Includes financial year (FY) funding for TV captioning of \$2.8m. No liability for this at 30 June.	79,152	62	26,233	30,400
<u>Regional TV</u> Largely FY funding. \$295,000 of the 30 June liability related to contracts specifically covering FY 2014/15.	1,200	1	326	261
<u>Digital Media</u> Mix of project and funding FY e.g. NZ On Screen \$1.25m. Liability relates to projects.	3,982	3	1,784	1,343
<u>Public Radio</u> All Radio NZ funding, relates to financial year. No remaining liability at year end.	32,516	26	0	0
<u>Special Interest Radio</u> Mostly Access Radio of approx \$5.6m which funds the financial year. No liability for this at year end.	6,281	5	258	406
<u>Music and other content</u> Mix of music recordings and videos and other music. Includes funding on a financial year basis of \$469k for The Audience website, liability at 30 June \$65k; and alternative radio \$920k, liability \$187k.	3,946	3	2,468	2,334
<u>Development and support</u> Funding for skills development, sponsorship and events	409	0	167	183
Total	127,486	100%	31,236	34,927

2.2 Statement of comprehensive revenue and expense for the year ended 30 June 2017¹

	Actual 2017 \$000	Budget 2017 \$000	Actual 2016 \$000
Revenue			
Crown revenue	129,426	128,726	128,726
Other revenue	2,514	2,230	2,542
Total revenue	131,940	130,956	131,268
Operating expenditure			
Administration services	3,348	3,715	3,420
Total operating expenditure	3,348	3,715	3,420
Funding expenditure			
Screen content			
National television	79,152	79,300	81,477
Regional media	1,200	1,380	634
Digital-only media	3,982	3,860	3,848
Sound content			
Public radio	32,516	31,816	31,816
Special interest radio	6,281	6,645	6,458
Music and other content	3,946	4,000	3,779
Development & support funding	409	400	397
Total funding expenditure	127,486	127,401	128,409
Total expenditure	130,834	131,116	131,829
Net surplus/(deficit) for the year	1,106	(160)	(561)
Other comprehensive revenue and expense	-	-	-
Total comprehensive revenue and expense	1,106	(160)	(561)

Also noted in the annual report:

“We ended the year with a surplus, due to approved funding of \$2.6m being carried into the next financial year for projects where funding conditions were not yet met at 30 June. If all projects had met funding conditions, we would have ended the year with a deficit of \$1.5m and equity of \$0.5m.”

This relates to conditions for funding to proceed not being met where third party funding was not in place at balance date.

¹ A full copy of the 2016/17 annual report can be accessed on line at www.nzonair.govt.nz

2.3 Statement of financial position as at 30 June 2017

	Actual 2017 \$000	Budget 2017 \$000	Actual 2016 \$000
Current assets			
Cash and cash equivalents	5,188	3,000	8,655
Investments	27,000	20,000	28,000
Debtors and other receivables - interest	195	150	178
Debtors and other receivables - other	1,843	150	172
Total current assets	34,226	23,300	37,005
Non-current assets			
Property, plant and equipment	162	350	240
Intangible assets	185	-	12
Total non-current assets	347	350	252
Total assets	34,573	23,650	37,257
Current liabilities			
Trade and other payables	194	300	291
Employee entitlements	121	150	123
Funding liabilities	31,236	23,153	34,927
Total current liabilities	31,551	23,603	35,341
Net assets	3,022	47	1,916
Equity			
Equity at 30 June	3,022	47	1,916
Total Equity	3,022	47	1,916