1.001 The Audit Office issued its audit report on the *Financial Statements of the Government of New Zealand for the year ended 30 June 1999* (the *Financial Statements*)[1] on 10 September 1999. This is the same date on which the Treasurer, the Minister of Finance, and the Secretary to the Treasury signed their Statement of Responsibility for the *Financial Statements*.

Unqualified Opinion Issued

1.002 The audit report appears on pages 22-23 of the *Financial Statements*. The report includes our unqualified opinion that those statements:

- *comply with generally accepted accounting practice; and*
- *fairly reflect:*
  - *the results of operations and cash flows for the year ended 30 June 1999; and*
  - *the financial position as at 30 June 1999.*

1.003 As in previous years, the Treasury has provided a comprehensive commentary on the financial performance and position, which is presented on pages 10-20 of the *Financial Statements*.

1.004 Nevertheless, we draw attention to the following significant items reflected in the reported results.

Accident Rehabilitation and Compensation – Recognition of Unfunded Liability

1.005 As indicated on page 15 of the *Financial Statements*, the Accident Rehabilitation and Compensation Insurance Corporation (ARCIC) and the Crown have recognised the future costs of past claims to ARCIC as at 30 June 1999.

1.006 The initial recognition of this liability has had a net negative impact of some $6,100 million on the Crown's net worth as at 30 June 1999.

1 Parliamentary paper B.11.

1.007 The Audit Office has worked closely with officials from the Treasury and the Department of Labour in considering the actuarial, accounting and disclosure implications of recognising this liability for the first time.

1.008 ARCIC has obtained actuarial valuations of the liability for a number of years, and these valuations were used to support the note disclosure of the unfunded liability in the financial years ended 30 June 1995 to 1998.

1.009 This financial year, the Department of Labour, in consultation with the Treasury and the Audit Office, obtained an independent actuarial valuation of the liability. The valuation included a reconciliation of any differences with ARCIC's own actuarial valuation (these differences were minimal in relation to the total liability).

1.010 The Audit Office has publicly promoted the recognition of this liability since 1997, in order that:

- ARCIC's and the Crown's financial statements fairly reflect the unfunded liability which has arisen since the scheme was moved from a fully funded to a 'pay as you go' scheme. (Note that ARCIC's levies now include an amount to move the scheme back on to a fully funded basis – for the employers account – over the next fifteen years.)
- There is full transparency (and, thus, accountability) of the impacts of management decisions on the unfunded liability balance on a year-on-year basis. Movements in the balance will be reflected in ARCIC's and the Crown's operating balance as from 1 July 1999. Potentially, these movements are significant, depending in particular on:
  - the number of long-term claimants who will leave the scheme over the next few years; and
  - movements in the risk-free rates of return used to discount the liability to its net present value.

The Public Trust Office

1.011 As indicated on page 12 of the *Financial Statements*, the reserves of the Public Trust Office have now been recognised as an investment in the *Financial Statements*. These reserves total some $86 million as at 30 June 1999.

1.012 The ownership of these reserves had been subject to legal dispute and the Court of Appeal ruled in the Crown's favour in March 1999.[2]

1.013 This was one of the last significant outstanding issues in accounting for the Crown's estate in the *Financial Statements*. The remaining issue to be resolved is the inclusion of urban highways (discussed in paragraphs 1.016-1.019).

Government Superannuation Fund – Movement in Unfunded Liability

1.014 As discussed on page 17 of the *Financial Statements*, during the year the Government Superannuation Fund experienced significant movement in the unfunded liability. The liability at the start of the year was $8,095 million. By 31 December 1998 it had dropped by $217 million to $7,878 million (which was the figure used for forecasting purposes in the 1999 Budget). As at 30 June 1999 the liability had increased by $646 million to $8,524 million.

1.015 These fluctuations illustrate the significant movements that can occur (and their effect on the Crown's net worth) as a result of changes in financial assumptions and fund experience – as we have highlighted in the case of the ARCIC unfunded liability (see paragraphs 1.005-1.010).

Urban Highways – Who Should Account for Them?

1.016 Transit New Zealand (TNZ) has legal opinions that indicate that the Crown owns rural state highways and motorways and local authorities own urban state highways. Urban state highways have a value based on depreciated replacement cost of approximately $1,300 million.

2 *Contradictors v Attorney-General* [1999] 2 NZLR 523.

1.017 However, many local authorities do not account for urban state highways within their financial statements because TNZ fully funds the state highway network and, in their view, TNZ effectively has control of the asset. At present, many of these roads are not accounted for in either the Crown's or local authorities' financial statements.

1.018 We will work with the Treasury with a view to resolving this issue by 30 June 2000. A potential outcome is that the Crown recognises this asset in the *Financial Statements*. The topic is discussed in the 1999 *Pre-election Fiscal and Economic Update*.[3]

1.019 With the likely issue in 2000 of a Financial Reporting Standard on Accounting for Property, Plant and Equipment, changes may be required to valuation methodologies presently applied to roading. Again we will work with TNZ and the Treasury to resolve any issues arising.

Environmental Liabilities

1.020 A proposed draft Financial Reporting Standard on Provisions, Contingent Liabilities and Contingent Assets highlights the need for the Crown to identify and assess all potential liabilities. The recognition of environmental obligations is an emerging issue, and the Audit Office is gathering information to determine the nature and extent of potential environmental obligations of entities within the Crown estate. We will also consider the position in local government where the Crown may be exposed to residual liability issues.

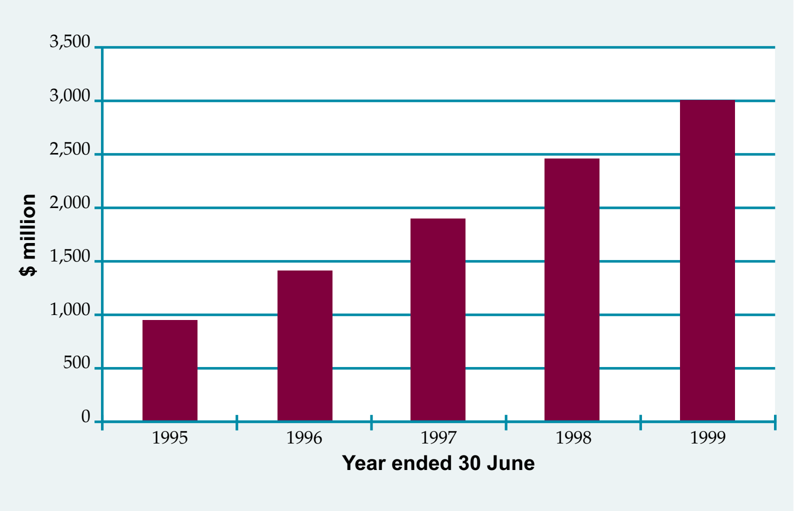
1.021 We will continue to work with the Treasury in developing our understanding of this issue and considering any potential accounting implications that may arise.

3 Parliamentary paper B.16, page 57.

Student Loan Debt

1.022 Current and former tertiary students owed the Crown some $3,002 million as at 30 June 1999. This asset is shown under advances in the Crown's Statement of Financial Position and is net of any write-offs and provisions (which currently stand at 10% of the gross debt). This is a significant asset for the Crown that has grown rapidly as illustrated in Figure 1.1.

Figure 1.1
Student Loan Debt 1995-1999



1.023 Total student loan debt is projected to grow at similar rates in future years. This rate of increase raises questions as to the level and extent of information – such as profiles of the age, individual amounts outstanding, and expected maturities – that it is appropriate to disclose.

1.024 The Treasury is considering alternative valuation strategies. The Audit Office is evaluating the adequacy of current information and will report further in 2000.

Valuation of Investments in State-owned Enterprises and Crown Entities

1.025 The Crown has $12,900 million invested in the net assets of State-owned enterprises and Crown entities. This large and diverse investment portfolio gives rise to a range of valuation issues. For example, the split of Electricity Corporation of New Zealand into three entities requires each of them to be revalued in light of their differing circumstances.

1.026 The Audit Office will work with the Treasury in addressing these issues, and we will consider the nature of any further audit work that may be necessary.

Full Consolidation

1.027 As discussed in previous years, we anticipate that the Crown's exemption from having to prepare fully consolidated financial statements will be removed when the new financial reporting standard covering consolidation of investments in subsidiaries is promulgated. The Treasury and the Audit Office are giving continuing consideration to the implications of full consolidation from a financial reporting and auditing perspective.