Financial (Prudence) Reporting Regulations - Net Debt explanation

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The broad approach to the financial prudence indicators is that information is to be consistent with GAAP. If a term has been defined in the regulations, its because there is no GAAP definition of the term. DIA has taken definitions from the Glossary of defined terms in IPSAS PBE standards, at http://www.xrb.govt.nz/Site/Accounting_Standards/Current_Standards/Standards_for_Public_Sector_PBEs/Stds_for_PS_PBEs_T1-4.aspx.

In the case of the discussion on how net debt is to be calculated, the definition is net debt means financial liabilities less financial assets (excluding trade and other receivables). Both financial assets and financial liabilities have GAAP definitions.

Financial liability is defined in PBE IPSAS 28 as:

> "Any liability that is:
>
> (a) A contractual obligation:
>
>> (i) To deliver cash or another financial asset to another entity; or
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>> (ii) To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
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> (b) A contract that will or may be settled in the entity's own equity instruments and is:
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>> (i) A non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
>>
>> (ii) A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 15 and 16, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.
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> As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraph 15 and 16 or paragraphs 17 and 18."

Financial asset is defined in PBE IPSAS 28 as:

> "Any asset that is:
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> (a) Cash;
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> (b) An equity instrument of another entity;
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> (c) A contractual right:
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>> (i) To receive cash or another financial asset from another entity; or

(ii) To exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or

(d) A contract that will or may be settled in the entity’s own equity instruments and is:

(i) A non-derivative for which the entity is or may be obliged to receive a variable number of the entity’s own equity instruments; or

(ii) A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity’s own equity instruments. For this purpose the entity’s own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 15 and 16, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the entity’s own equity instruments.”

A key issue with the definition of financial assets is that it includes equity instruments of other entities. This will include the value of investments in CCOs and in shares held as part of council investment funds. This was deliberate, to cover the situations of councils such as New Plymouth, Taupo, and Environment Bay of Plenty for example.

Regulation 22(1) is explicit that actual net debt is to be compared with planned net debt “for the end of the year in its long-term plan”. The benchmark is intended to help identify any local authority where cost over-runs are being funded by additional debt. Using the long-term plan is designed to catch creeping increases in planned debt. If a council makes a conscious decision to bring forward a project, resulting in debt levels exceeding its planned LTP levels, then that can be explained in the commentary on the benchmarks.