



Cabinet Social Wellbeing Committee

Minute of Decision

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Veterans' Support Entitlement Obligation

Portfolio **Veterans**

On 24 March 2021, the Cabinet Social Wellbeing Committee:

- 1 **noted** that a new accounting standard on employee benefits has resulted in the recognition of a \$3.483 billion veterans' support entitlement obligation on the government balance sheet at 30 June 2020;
- 2 **noted** that:
 - 2.1 in November 2019, Cabinet agreed changes for inclusion in the Veterans' Support Amendment Bill and approved minor appropriation increases of \$0.300 million for changes to Veterans' pension entitlements [CAB-19-MIN-0566];
 - 2.2 in the first quarter of 2020, the Minister for Veterans made a declaration of 'qualifying operational service', resulting in 850 new veterans;
 - 2.3 these decisions have resulted in financial implications amounting to \$88.904 million, which were declined as part of the Vote Defence Force October Baseline Update submission;
- 3 **noted** that Cabinet approval is needed for the financial adjustment outlined in paragraph 2.3 above;
- 4 **agreed** to the financial implications associated with the two previous policy decisions, as outlined in paragraph 2 above;
- 5 **noted** that \$10.000 million of the expenditure increase in paragraph 2.3 above can be absorbed within the existing service cost appropriation;
- 6 **approved** the following changes to appropriations to give effect to the decisions in paragraph 4 above, with a corresponding impact on the operating balance:

	\$m - increase/(decrease)				
Vote Defence Force Minister for Veterans	2020/21	2021/22	2022/23	2023/24	2024/25 & Outyears
Non Departmental Other Expense					
Service Cost – Veterans' Entitlements (M75)	78.904	-	-	-	-

- 7 **agreed** that the changes to appropriations for 2020/21 above be included in the 2020/21 Supplementary Estimates and that, in the interim, the increase be met from Imprest Supply;
- 8 **noted** that the Minister of Finance has decided the expenses incurred under paragraph 6 above will not be a charge against the operating allowances, therefore resulting in a direct fiscal impact on the operating balance and net core Crown debt;
- 9 **noted** that the New Zealand Defence Force is continuing to work with its auditors and the Treasury to clarify how changes impacting the value of the obligation are reflected in appropriations and are treated under the fiscal management approach.

Rachel Clarke
Committee Secretary

Present:

Hon Kelvin Davis
Hon Dr Megan Woods
Hon Carmel Sepuloni (Chair)
Hon Andrew Little
Hon Kris Faafoi
Hon Peeni Henare
Hon Willie Jackson
Hon Dr Ayesha Verrall
Hon Meka Whaitiri
Hon Priyanca Radhakrishnan
Hon Marama Davidson

Officials present from:

Office of the Prime Minister
Office of the SWC Chair
Officials Committee for SWC

Proactively Released by the Minister for Veterans

Chair, Cabinet Social Wellbeing Committee

VETERANS: VETERANS' SUPPORT ENTITLEMENT OBLIGATION

Proposal

- 1 This paper seeks approval of a \$78.904 million uplift in Vote Defence Force Non-Departmental appropriations to align with the increase in the Veterans' Support Entitlement Obligation for decisions made in 2019 and 2020.

Relation to Government Priorities

- 2 This paper does not align to any current Government priorities or Manifesto commitments.

Background

- 3 This is a proposed increase to appropriations required to reflect policy decisions made by Cabinet in 2019 and the previous Minister for Veterans which had significant financial implications. A recent change in accounting standards has amplified the magnitude of the upfront expense requiring appropriation when policy changes relating to veterans' support entitlements are made.
- 4 The New Zealand Defence Force (NZDF), through Veterans' Affairs, administers the payment of veterans' support entitlements under the Veterans' Support Act 2014 (the Act). Historically, amounts paid to veterans as a consequence of a service-related injury, disease or death were recognised as expenses (impacting OBEGAL¹) at the time a payment was made through Benefits or Related Expenditure appropriations.
- 5 The External Reporting Board issued a new accounting standard in 2019 on employee benefits² which has changed the way expenses are recorded in respect of veterans' support entitlements. Rather than recording an expense when the payment falls due, the expense is now recognised much earlier; at the point the veteran becomes eligible to receive support from the Crown.
- 6 The earlier expense must now reflect the full cost of the entitlements at the point a veteran becomes eligible for support. As a result, a long-term liability is recorded on the Crown's balance sheet to represent the full cost of the Crown's financial obligation to eligible veterans, calculated based on estimated future entitlement payments discounted to today's dollars. This obligation was valued at \$3.483 billion on 30 June 2020.
- 7 While the way expenses are recorded has changed with the new accounting standard (impacting OBEGAL), the impact on Net Debt is unchanged because the timing of actual support payments made to veterans is unchanged.

¹ Operating Balance Excluding Gains and Losses

² Public Benefit Entity – International Public Sector Accounting Standard (PBE IPSAS 39) *Employee Benefits* is effective for accounting periods beginning on or after 1 January 2019.

- 8 Going forward, the liability on the balance sheet will change and be updated each year. For example, the liability will increase (and an expense will be recorded) for the full cost of any new support entitlements or new declarations of qualifying service. A Non-Departmental Other Expense appropriation (Service Cost – Veterans’ Entitlements) was established on 1 April 2020 in anticipation of these types of new expenses³. The approved appropriation amount for 2020/21 is \$20 million.
- 9 As the obligation is discounted to present value, the discount incorporated into the liability value unwinds over time. This increase is recorded as an interest expense in the Non-Departmental Other Expense appropriation: *Unwind of Discount Rate – Veterans’ Entitlements*.
- 10 In addition, the total liability on the Crown balance sheet will be revalued regularly, usually annually. This process involves the actuary updating various valuation assumptions (for example, discount rates and CPI) and re-calculating the value of the obligation. Depending on how assumptions are changed, these annual valuations can result in either increases or decreases in the liability on the Crown’s balance sheet.
- 11 Annex A illustrates how changes to veterans’ support entitlements (for example, due to policy changes) impact appropriations under both the old and new treatment.

Increases to the obligation

- 12 The previous Minister for Veterans sought approval for the appropriation impacts of veterans’ support entitlements decisions taken over the last year through the October Baseline Update as a technical adjustment. The Minister of Finance declined this request because joint Ministers do not have authority to approve increases in appropriations that are the result of policy decisions– only Cabinet does.⁴

Declarations of ‘qualifying operational service’

- 13 NZDF personnel meet the definition of a veteran under the Act, and thereby become eligible for veterans’ support entitlements, when they have participated in a deployment or activity that is declared to be ‘qualifying operational service’.
- 14 In the first quarter of 2020/21, the previous Minister for Veterans declared 14 historic deployments to be ‘qualifying operational service’ under the Act. The effect was to give ‘veteran’ status to all the current and former NZDF personnel who served on those deployments and who did not already have ‘qualifying operational service’. This decision resulted in 850 new veterans.
- 15 When these declarations were made, the impact on the obligation was unknown and a Specific Fiscal Risk was included in the Pre-Election Economic and Fiscal Update as a result. The impact has been subsequently valued at \$78.384 million.

Impact of the Veterans’ Support Amendment Act 2020

- 16 A further increase in the obligation in 2020/21 has resulted from Cabinet’s decision in November 2019 to expand a limited number of entitlements in response to the 2018 Paterson Report on the Act [CAB-19-MIN-0566 refers]. Cabinet agreed to

³ Expense appropriations in respect of veteran’s entitlements needed to be updated with the new accounting standard in 2019 because appropriations must align with accounting definition of expenses.

⁴ Cabinet Manual, paragraph 5.12.

provide new funding of approximately \$0.300 million per annum for these changes, based on the accounting approach at the time.

- 17 The obligation for these changes was not recognised in the initial valuation of the obligation as these changes were not expected to come into force until 1 April 2021. The Amendment Act was since passed on 1 October 2020, which means the increase to the obligation must now be recognised. The impact on the obligation of these changes has been subsequently valued at \$10.520 million.

Framework for future policy changes

- 18 The NZDF, through Veterans' Affairs, is working with its auditors and Treasury to develop a framework to clarify how changes impacting the value of the obligation are reflected in appropriations and treated under the fiscal management approach. This framework will support NZDF to manage the financial implications of future decisions impacting on the Veterans Support Entitlement Obligation.

Financial Implications

- 19 The combined impact of these decisions increases the value of the obligation, and consequently the expenditure to be charged against the *Service Cost – Veterans' Entitlements* appropriation, by \$88.904 million in 2020/21 (being the present value of the lifetime costs of these policy decisions, discounted to today's dollars). This comprises:
- 19.1 \$78.384 million for the lifetime cost of the 14 new declarations; and
 - 19.2 \$10.520 million for the lifetime cost of the changes to entitlements from the Amendment Act.
- 20 The \$88.904 million represents an estimate of the cost across the lifetime of the decisions and is based on the best information available at the time of preparing this paper. An external actuary partner has been used to assist the NZDF and Veterans' Affairs calculate the value of the obligation and determine cost assumptions for changes to the obligation.
- 21 The NZDF has assessed that \$10.000 million of this expenditure can be absorbed within the existing baseline. This is after forecasting the impact of upcoming deployment decisions and building in a contingency of \$4.900 million to cover the potential costs of any further upcoming decisions. Policy decisions that historically have had a minor impact on expenditure have proved to have significant financial implications under the new treatment, so a contingency of this size is considered necessary to mitigate the risk of unappropriated expenditure.
- 22 It is recommended that the remaining increase of \$78.904 million is funded by an increase to the *Service Cost – Veterans' entitlements* appropriation.
- 23 The increase to the *Service Cost – Veterans' entitlements* appropriation is classified as a non-departmental expense and is set out in the table below:

	\$m increase/(decrease)				
Vote Defence Force Minister for Veterans	2020/21	2021/22	2022/23	2023/24	2024/25 & Outyears
Non-Departmental Other Expense					
Service Cost – Veterans' Entitlements	78.904	-	-	-	-

24 The Minister of Finance has decided that this increase in appropriations is dealt with outside the current operating allowances, therefore resulting in a direct fiscal impact on the operating balance and net core Crown debt.

Consultation

25 Treasury have been consulted on this paper and are working with the NZDF on the development of a framework for future policy changes with an impact on veterans' support entitlements.

Legislative (and Other) Implications

26 There are no legislative or regulatory implications. No impact analysis is required. There are no climate, human rights, gender or disability implications.

Publicity

27 No publicity is planned for this paper.

Proactive Release

28 This paper and other relevant papers will be proactively released (with appropriate redactions).

Recommendations

29 I recommend that the Committee:

1. **note** that a new accounting standard on employee benefits has resulted in the recognition of a \$3.483 billion veterans' support entitlement obligation on the Government balance sheet at 30 June 2020;
2. **note** that in 2019 and 2020, Cabinet and the previous Minister for Veterans respectively made two policy decisions (legislative changes and declarations of 'qualifying operational service') with financial implications amounting to \$88.904 million, which were declined as part of the Vote Defence Force October Baseline Update submission;
3. **note** that joint Ministers do not have authority to make these changes, so Cabinet approval is required;
4. **agree** to the financial implications associated with the two policy decisions in recommendation 2 above;
5. **note** \$10.000 million of the increase in expenditure can be absorbed within the existing service cost appropriation;
6. **approve** the following changes to appropriations to give effect to the decisions at recommendation 4 above, with a corresponding impact on the operating balance;

	\$m - increase/(decrease)				
Vote Defence Force Minister for Veterans	2020/21	2021/22	2022/23	2023/24	2024/25 & Outyears
Non Departmental Other Expense Service Cost – Veterans' Entitlements (M75)	78.904	-	-	-	-

7. **agree** that the proposed changes to appropriations for 2020/21 above be included in the 2020/21 Supplementary Estimates and that, in the interim, the increase be met from Imprest Supply;
8. **note** that the Minister of Finance has decided the expenses incurred under recommendation 6 above will not be a charge against the operating allowances, therefore resulting in a direct fiscal impact on the operating balance and net core Crown debt; and
9. **note** that the NZDF is continuing to work with its auditors and Treasury to clarify how changes impacting the value of the obligation are reflected in appropriations and are treated under the fiscal management approach.

Authorised for lodgement

Hon Meka Whaitiri
Minister for Veterans

/ / 2021

Annex A: Example of Financial Implications of a Policy Change

