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Gambling machines and accounting

M B Rodriguez Ferrere, the University of Otago

on accounting for the costs of "pokies" machines

The decision in *Pub Charity v Department of Internal Affairs* [2013] NZHC 3311 shows the importance of recognised accounting standards in statutory interpretation, even in the highly-specialised gaming industry.

New Zealand has 17,266 gaming machines and around $850 million per year is spent using them. The operation of those machines is classified as "class 4 gambling" by the Gambling Act 2003, and the Department of Internal Affairs will only grant class 4 licences to operators who use the proceeds for an authorised purpose. The distribution of these proceeds is tightly controlled; the Act and the Gambling (Class 4 Net Proceeds) Regulations 2004 require operators to distribute a minimum percentage of the proceeds to the community (37.12 per cent) and limit the amount that the operator can use to pay its costs (62.88 per cent).

Pub Charity Ltd is one of New Zealand's largest gaming machine operators, with nearly 1,800 machines around the country. It sought declarations from the Court regarding a narrow issue: the treatment of gaming machines for accounting purposes. Whilst this issue might seem innocuous in the abstract, viewed globally, the sums involved in the gaming industry made it worthy of proceedings.

Pub Charity argued that cost of a gaming machine ought to be fully accounted for in the year it was purchased. The Department argued that the cost of the machine should be spread over its lifetime, that is, depreciated. The difference in approach was relevant to the calculation of net proceeds under the Act: changes in an operator's expenses in any given year would affect its ability to meet minimum distribution requirements.

The Department's interpretation was based on international accounting standards: not-for-profit organisations, such as Pub Charity, should "treat the cost of a capital asset as an expense over its estimated useful life" (at [7]). Pub Charity's contrary argument was based on a literal interpretation of the Act. The definition of "net proceeds" in s 4 of the Act refers to "the actual, reasonable, and necessary costs [...] incurred in conducting [...] gambling". Pub Charity argued that the reference to actual costs must mean the actual purchase price of a machine rather than a smaller depreciated figure.

That argument relied upon the Supreme Court decision in *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36, [2007] 3 NZLR 767. There, the Court held that the plain meaning of "cost of capital" as it appeared in regulations should be preferred, even if accountants would treat this as actually meaning "weighted cost of capital". Tipping J remarked (at [23]) that "The concept of a plain and ordinary meaning does not involve the Court having recourse to external sources such as expert evidence and textbooks. If the Court has to do that there can hardly be a plain meaning." Pub Charity argued that similarly, the plain meaning of "actual cost" ought to be preferred over a depreciated cost, even if textbooks and expert evidence suggested the contrary.

Simon France J rejected Pub Charity's argument. Whilst accepting Tipping J's approach in *Fonterra*, he noted it did not overcome "the fundamental difficulty for Pub Charity that it in no sense strains the language of the Act to regard a depreciation expense as an actual cost within the ordinary meaning of the word" (at [14]). Depreciation was simply a different method of accounting for the cost of incurred expenditure; just because it was a cost spread over a period of time did not mean it fell outside of the ordinary definition of "actual cost"; a definition excluding depreciation would be far too narrow.

Pub Charity also argued that a narrow reading of "actual" that deviated from international accounting standards was required to support the scheme of the Act. Since the Act mandated tight control of operators' expenses, an interpretation ought to avoid the subjectivity involved in determining depreciation costs. This was rejected by the Court, especially in light of s 108, which deals with an operator's annual report, and refers explicitly to "generally accepted accounting practice". As Simon France J noted, "It would make it most unexpected to find that elsewhere the Act required proper accounting approaches to be ignored" (at [21]). Accordingly, the Court preferred the Department's interpretation.

A second — but quickly dispensed — issue before the Court was whether the purchase of gaming machines should be treated as all other expenditure, that is, whether it should fall part of expenses that cannot exceed 62.88 per cent of an operator's proceeds. Pub Charity's argument for this interpretation was based on the definition of proceeds in reg 3(1) of the Regulations, which referred to "the turnover of the gambling [...] plus proceeds from the sale of [...] gambling equipment purchased from that turnover". Pub Charity argued that the reference to gambling equipment in the definition made it a special type of expense not subject to the same constraints. Simon France J disagreed, ruling once again that Pub Charity's interpretation was too literal and would undermine the purpose of the Regulations in restricting expenditure to that which is necessary and reasonable.

The Department suggested in argument that the motivation behind the proceedings was Pub Charity's desire to prevent new entrants in the market: accounting for the full cost of gaming machines in the first year of operation would make it difficult for new entrants to keep to their expenses within the mandated limits. Simon France J did not find this policy debate helpful. Instead, the Court adopted a refreshingly commonsense approach to statutory interpretation in this highly regulated industry, as well as showing the importance of accounting standards and their ability to displace a literal interpretation. ❐