NSW Financial Reporting Roadshow 2018

Office of Local Government

Purpose of the day

- Education about new accounting standards
- Opportunity to hear from NSW Audit Office
- Feedback about Code
- Open discussion about accounting issues
- Other financial reporting matters

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Agenda

9:30 – 9:45	Introduction
9:45 – 12:00	New Accounting Standards
12:00 – 12:30	**Lunch**
12:30 – 1:00	Auditing Local Government – Observations, themes and future direction
1:00 – 2:30	Accounting issues
2:30 - 3:30	Accounting Code
3:30	Close

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New Accounting Standards and the impact for Councils

AASB 9 *Financial Instruments*	15 mins
AASB 16 *Leases*	1 hour
AASB 15 / AASB 1058 *Revenue*	1 hour

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Timeline for new standards

30 June 2017
- Related party transactions for NFP public sector

30 June 2018

30 June 2019
- Financial instruments
- Revenue (FP)

30 June 2020
- Leases
- Revenue (NFP)
- Service concession arrangements

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AASB 9 *Financial Instruments*

- Effective for 30 June 2019
- Changes in relation to:
  - Classification of financial assets
    - Amortised cost or fair value
    - Equity through OCI*
    - All equity instruments at fair value*
  - Hedging
  - Impairment*
    - Only required for instruments held at amortised cost
    - Expected loss v incurred loss

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Classification changes

AASB 139

- Fair value through profit and loss
- Held-to-maturity investments
- Loans and receivables
- Available-for-sale

AASB 9

- Amortised cost
- Fair value through profit or loss
- Fair value through OCI – debt instruments
- Fair value through OCI – equity instruments

Equity instruments

All equity instruments to be held at fair value

Option for fair value movements unless instruments are held for trading or were part of contingent consideration in a business combination.

Equity instrument **not** designated through OCI (held for trading)

- Measured at fair value
- Changes in value / gains on sale through profit or loss

Equity instrument **designated** through OCI

- Measured at fair value
- Changes in value / gains on sale through OCI – no recycling
- Dividends through profit or loss

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Overview of model

Change in credit qualify since initial recognition

Stage 1 – Performing asset

- Initial recognition
- Instruments that have not had a significant increase in credit risk since initial recognition or those with low credit risk at reporting date
- 12 months expected credit losses being default events that are possible within 12 months.
- Recognise entire credit loss on asset weighted by the probability of default event.

Stage 2 – underperforming asset

- Assets with significant increase in credit risk since initial recognition
- Recognise lifetime expected credit losses

Stage 3 – non-performing assets

- Credit impaired assets
- Recognise lifetime expected credit losses

Statutory receivables

An entity recognises and measures a statutory receivable as if it were a financial asset when statutory requirements establish a right for the entity to receive cash or another financial asset.

Prepaid rates will not be recognised as income until beginning of rating period.

AASB 16
LEASES

Headlines – what is changing?

Changes to lessor accounting
No significant changes – substantially carry forward of AASB 117 requirements – operating v finance lease classification
Some additional disclosures
Changes to lessee accounting
Former operating leases capitalised. Most leases will be accounted for using a similar approach to the finance leases of today
Balance sheet – increase in leased assets and financial liabilities
Income statement – decrease in operating expenses, increases in finance costs
Statement of cash flows – increase in operating cashflows, increase in financing cash out flows

No impact on the lessee's economic position or commitments to pay cash

What is a lease?

A lease is a contract or part of a contract that conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

Is there an identified asset?

No

Yes

Does the lessee obtain all economic benefits from the use of the asset?

No

Yes

Does the lessee direct the use of the asset?

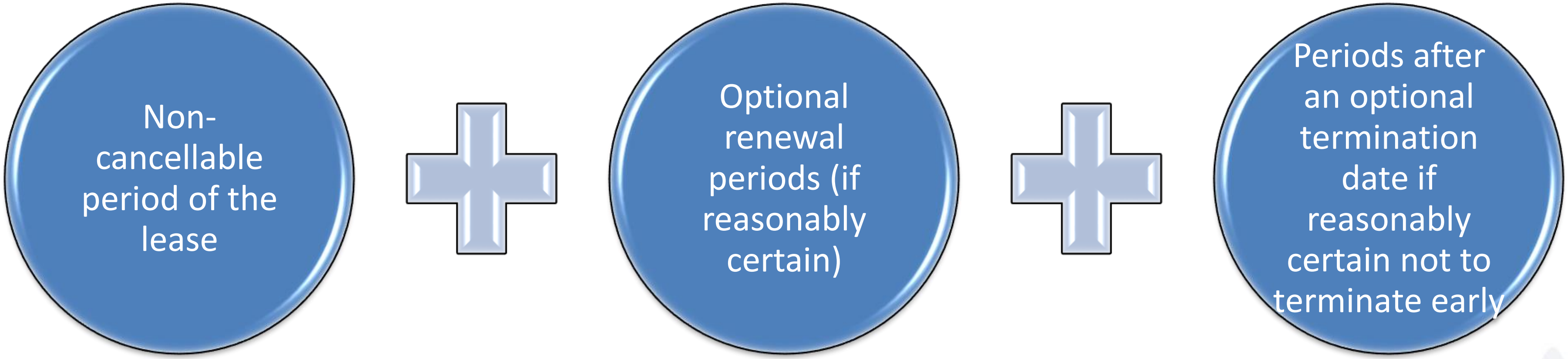
No

Yes

Contract is or contains a lease

Contract does not contain a lease

Lease term



Lease term starts when the lessor makes the underlying asset available for use by the lessee – commencement date

Two optional exceptions from recording leases

Short term leases

Low value assets

Account for leases similar to current operating leases – with lease payments recognised as an expense on a straight-line basis over lease term

Short-term lease exception

Short-term if it has a lease term of 12 months or less at the commencement date.

- If lease includes a purchase option then it is not short-term.

Lease term excludes any option period unless then lessee is reasonably certain to exercise the option (or reasonably certain not to exercise an option to terminate the lease)

Accounting policy choice must be made consistently for each class of underlying asset.

Low value assets

- Assess the value of the asset when new
- Basis of conclusion refers to US$5,000 – not a ‘bright-line’ rule
  - Low value IT equipment, office equipment and furniture
- Accounting policy choice on lease-by-lease basis

Example (AASB 117)

Lease of building – 3 year term – operating lease

Year 1 - $5,000 per month

Year 2 - $6,000 per month

Year 3 - $7,000 per month

Rate implicit in the lease is 10% p.a.

Total lease payments	$216,000 (being ($5,000+$6,000+$7,000) *12
Straight line expense	$72,000 (being $216,000 / 3 years)

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AASB 16 Fundamental Principle

Balance sheet
- Right to use asset (tangible)
- Lease liability

Income statement
- Interest and depreciation expense
- Impairment of right-of-use asset
- Variable lease payment not dependent on an index

All leases on statement of financial position (balance sheet)

Two exceptions

Same facts as earlier example

Amortisation table 3 years at rate implicit in the lease of 10%

Year	Cash payments ($)	Interest expense ($)	Principal repaid ($)	Closing balance ($)
0	-	-	-	185,947
1	60,000	16,080	43,920	142,027
2	72,000	10,223	61,777	80,247
3	84,000	3,753	80,247	-

Initial right of use asset = $185,947
Depreciated over 3 years ($61,982 per annum)
Lease liability – initial value $185,947

Journal entries

Initial recognition:

	Dr	Cr
Dr: Right of use	185,947	
Cr: Lease liability		185,947

In year 1:

	Dr	Cr
Dr: Interest	16,080	
Dr: Lease liability	43,920	
Dr: Depreciation expense	61,982	
Cr: Cash		60,000
Cr: Right of use asset		61,982

Statement of cash flows impact

Operating cash flows	Remove cash flows relating to rent expense
Financing cash flows	Include principal component of lease payments

Accounting Code mandates that interest component of the lease payments is included in operating cash flows

Separating lease and non-lease components

Where the contract contains a lease and an agreement to purchase or sell other goods or services (non-lease components) then the non-lease components are identified and accounted for separately. The consideration is allocated between the lease and non-lease components on the basis of their stand-alone selling prices.

- E.g. lease for property typically includes maintenance and security.

Practical expedients

1. lessees are permitted to make an accounting policy election, by class of underlying asset, to account for each separate lease component of a contract and any associated non-lease components as a single lease component.
2. Elect not to reassess whether existing contracts contain a lease on transition.

Measurement of lease liability

Include	Exclude
• Fixed payments (includes inflation linked) • Optional payments is reasonably certain • Residual value guarantee	• Variable lease payments linked to sales or use • Optional payments NOT reasonably certain • Service payments

Discount rate

- Present value of the lease payments is calculated using the interest rate implicit in the lease
  - i.e. rate that causes the present value of the lease payments and unguaranteed residual to equal the sum of the fair value of the underlying asset and any initial direct costs of the lessor.
- If not readily determined then use lessee incremental borrowing rate.

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Re-measurement of lease liability

Lease liability is re-measured with a corresponding adjustment to the right-of-use asset when:

- The lease term is revised
- Future lease payments based on an index or rate are revised
- The lease is modified
- There is a change in the amounts expected to be paid under residual value guarantees.
- Need to adjust the tax balance to the revised value of asset and liability

Discount rate will need to be revised in certain circumstances.

Initial measurement of the right of use asset

Lease liability

+

Initial direct costs

+

Prepaid lease payments

+

Estimated costs to dismantle, remove or restore

−

Lease incentives received

Lease incentives

Lessees

- Lease incentives paid or payable to the lessee are deducted from lease payments → reduce the initial measurement of the right-of-use asset
- Lease incentives payable to the lessee at lease commencement reduce a lessee's lease liability.

Lessors

- Lease incentives paid or payable to the lessee → deducted from lease payments and affect lease classification test
- Finance leases – lease incentives payable to the lessee reduce the expected lease receivable at commencement date and initial measurement of net investment in the lease
- Operating leases – lessors defer cost and recognise as a reduction to lease income

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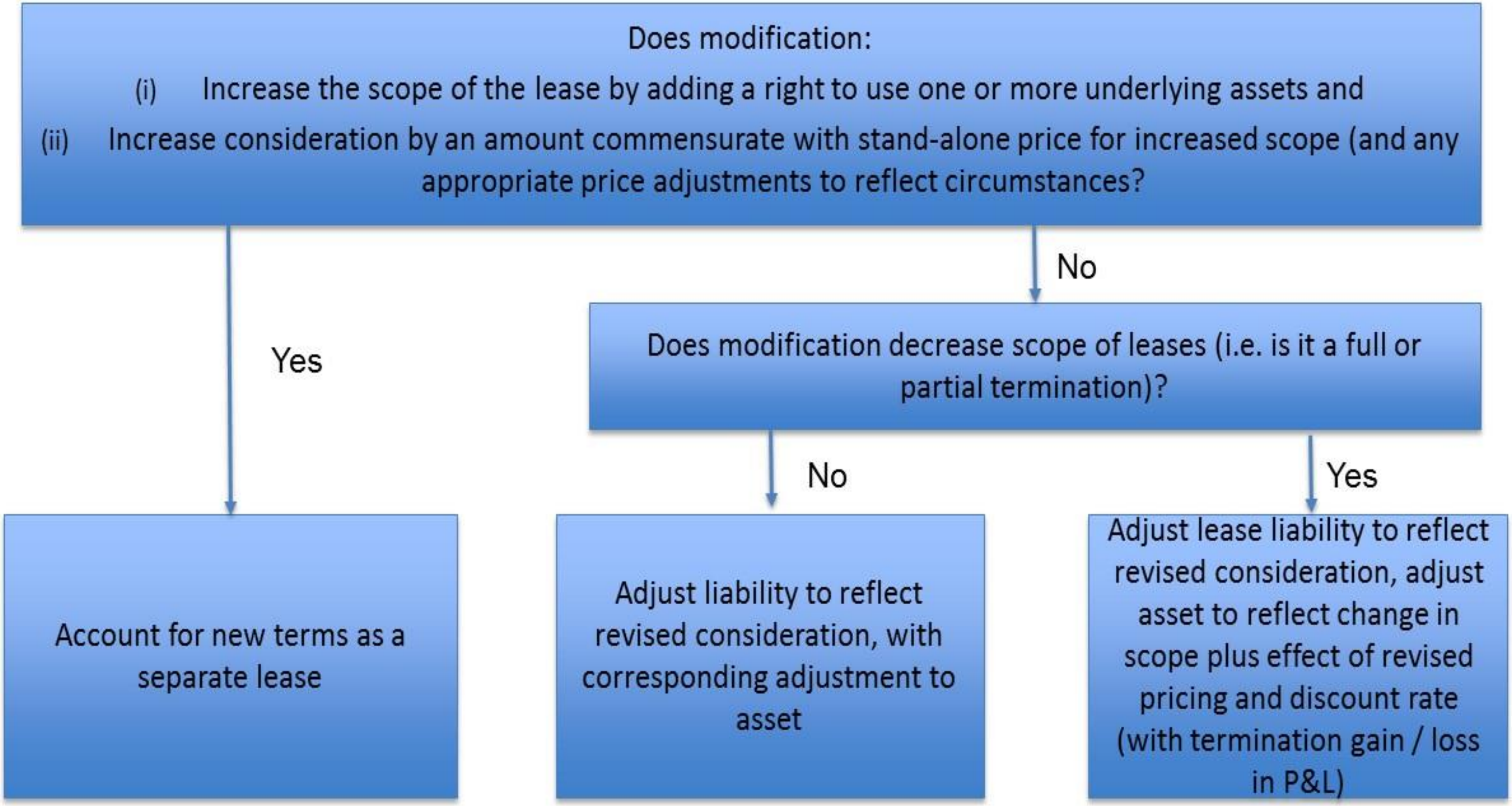
Accounting for lease modifications - lessee



Subleases

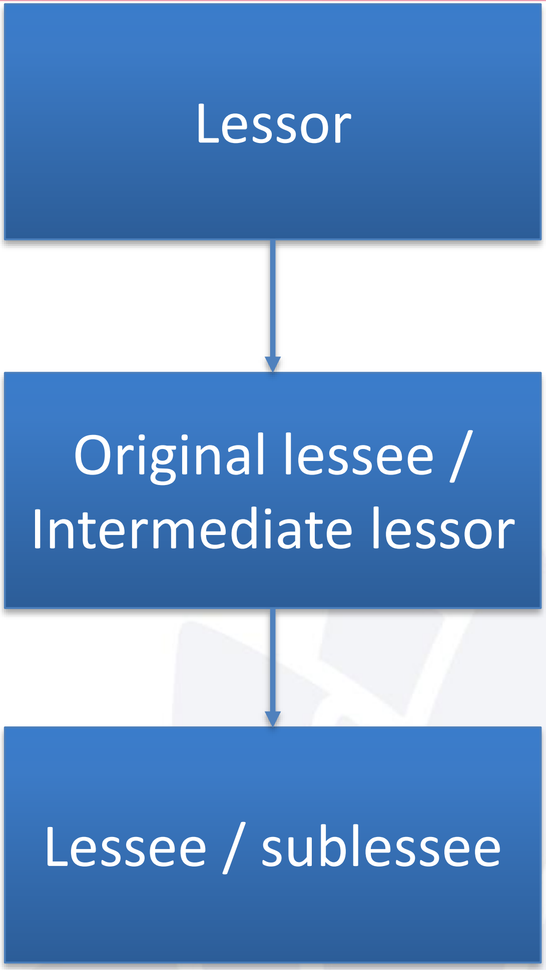
Original lessee generally continues to account for the original lease (head lease) as a lessee and accounts for the sublease as the lessor (intermediate lessor).

- Landlord considers lease classification based on right-to-use asset rather than underlying asset when classifying as operating or finance

When the head lease is a short term lease, the sublease is classified as an operating lease.

  – Otherwise the sublease is classified as either a finance or operating lease depending on the terms.

An intermediate lessor who subleases cannot account for the head lease as a lease of low value assets.



Classification of a sublease

Entity F (original lessee / intermediate lessor) leases a building for five years.

The building has an economic life of 30 years. Entity F subleases the building for 4 years.

The sublease is classified with reference to the right-of-use asset in the head lease (and not the underlying building)

When assessing the useful life criterion – the sublease term of 4 years is compared with the 5 years right-of-use asset in the head lease rather than the 30 years useful life of the building.

Transition method (OLG will mandate)

Lessee - Choice of two transition methods:

Full retrospective – restatement of comparatives in accordance with AASB 108

Modified retrospective / cumulative catch up – do not restate comparatives. Cumulative effect of adopting AASB 16 is recognised as an adjustment to equity on date of initial application.

- Parallel systems for comparatives

- Line by line disclosure of changes for current and comparative year

- No parallel reporting

- Comparison between discounting operating leases at 31 December 2018 and lease liabilities at 1 January 2019

- Other optional practical expedients

Disclosure objective

Enable financial statement users to assess the effect that leases have on an lessee's financial statements (e.g.. the amount, timing and uncertainty of cash flows arising from leases).

AASB 16 requires lessees to present all disclosures in a single note or separate section in the financial statements.

Disclosures - lessees

Quantitative information about leases (generally in a tabular format)	• Depreciation charge for right-of-use asset by class of underlying asset • Interest expense on lease liabilities • Expense relating to low-value and short-term leases if exemption elected • Commitments for short-term leases if expense disclosed reflects a dissimilar lease portfolio to the period-end commitment • Expense relating to variable lease payments not included in lease liabilities • Income from subleasing • Total cash outflow for leases • Additions to right-of-use assets • Gains or losses from sale and leaseback transactions • Carrying amount of right-of-use assets at end of the reporting period by class of underlying asset • Maturity analysis of lease liabilities • Information about right-of-use assets that are investment property or revalued under AASB 116

Additional qualitative and quantitative information as necessary to meet the disclosure objective	• Nature of leasing activities
	• Future cash outflows to which the lessee is potentially exposed that are not reflected in the lease liabilities, including exposure arising from:
	    • Variable lease payments
	    • Extension and termination options
	    • Residual value guarantees
	    • Leases not yet commenced
	• Restrictions or covenants imposed by leases
	• Sale and leaseback transactions.

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Disclosures - lessors

Finance leases	• Selling profit or loss • Finance income on the net investment in the lease • Income relating to variable lease payments not included in the measurement of the net investments in the lease • Qualitative and quantitative explanation of significant changes in net investment in the lease • Maturity analysis of lease receivable

Operating leases	• Lease income, separating disclosing income for variable lease payments that do not depend on an index or rate
	• As applicable for underlying asset, relevant disclosures in:
	    • AASB 116 for leases of property, plant and equipment, disaggregated by class
	    • AASB 138, AASB 136, AASB 140 and AASB 141
	• Maturity analysis of lease payments

Other	• Additional qualitative and quantitative information about leasing activities as necessary to meet disclosure objectives, including but not limited to:
	    • Nature of leasing activities
	    • How the risk associated with any rights retained in the underlying asset is managed.

Business impacts

Changes to delegations policy	Impact on net result – depreciation / interest rather than rent	Lease v buy decisions
Analysis of IT systems	Internal management reporting	Accounting policies / processes for lease accounting


QUESTIONS

AASB 15 *Revenue from Contracts with Customers / AASB 1058* Income of Not-for-Profit Entities

Revenues of Council

Revenue:	
Rates and annual charges	AASB 1058 / AASB 15
User charges and fees	AASB 1058 / AASB 15
Interest and investment revenue	AASB 9
Other revenues	AASB 1058 / AASB 15
Grants and contributions provided for operating purposes	AASB 1058 / AASB 15
Grants and contributions provided for capital purposes	AASB 1058 / AASB 15
Net gain from the disposal of assets	AASB 116 / AASB 5
Fair value increment on investment properties	AASB 140
Net share of interests in joint ventures and associates using the equity method	AASB 128

What makes up these standards?

AASB 15

Compiled standard AASB 15

Amending standards:

- AASB 2016-3
- AASB 2016-7 (NFP only – deferral)
- AASB 2016-8 (NFP only – Appendix)

Basis for conclusions

Illustrative examples

AASB 1058

AASB 1058

Note that the basis for conclusions, amendments to other standards and illustrative examples are in the same document as the standard.

Two standards for Not-for-Profit revenue

AASB 1058

- Consideration to acquire an asset is significantly less than the fair value of the asset principally to enable an entity to further its objectives
- Revenue likely to be recognised on day 1

AASB 15

- In substance, contract is with a customer
- Agreement is enforceable AND

  Performance obligations are sufficiently specific
- Revenue may be able to be spread

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Enforceable and sufficiently specific

Enforceable

- Legal or equivalent means
- Ability to enforce
- E.g.
  - Refund
  - Right to enforce or claim damages
  - Right to assets

Sufficiently specific performance obligations

- Require judgement – implicit or explicit
- Consider:
  - Nature or type
  - Cost or value
  - Quantity
  - Time period (not enough on its own)

Overall principle of AASB 15 – what?

Recognise revenue in a way that shows the transfer of goods/services promised to customers in an amount reflecting the expected consideration in return for those goods or services.

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The 5 step path to revenue recognition under AASB 15

1. Identify the contract with the customer

2. Identify the performance obligations

3. Determine the transaction price

4. Allocate the transaction price to the performance obligations

5. Recognise revenue as the performance

Performance obligation

Performance obligation is a promise in a contract with a customer to transfer goods or services to the customer

Customer must be able to benefit from the good / service either on its own or with other readily available resources

+

The good / service is separately identifiable from other goods / services in the contract

Think about grant agreements – what are the promises?

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Principal or agent

If another party is involved in providing goods or services to a customer → determine if entity's promise is a performance obligation:

to provide the specified goods or services *itself*	Entity is principal → recognise revenue in the gross amount of consideration to which it expects to be entitled
to *arrange* for the other party to provide those goods or services	Entity is agent → recognise revenue in the amount of fee or commission to which it expects to be entitled

Any grants where Council is required to pass through to the community on behalf of someone else?

Contract costs

Costs to obtain a contract

Costs which would not have been incurred if the contract has not been won

Recognised as an asset if they are expected to be recovered

If expected period is less than 12 months then expense as a practical expedient

Costs to fulfill a contract

If these costs are within the scope of other standards (e.g.. AASB 102, AASB 116 or AASB 138) - treatment is in accordance with appropriate standard

If not, then you should capitalise them only if certain criteria are met

ED 283 *Australian Implementation Guidance for NFP Public Sector Licensors*

Aim to reduce diversity since treatment under AASB 15 is not clear as refers to IP licences only.

Amendments, guidance and illustrative examples to:

- Distinguish licences from taxes
- Determine the nature of licences
- Understand performance obligations.

Includes practical expedients for short-term or low-value licences.

Comment period ends 31 March 2018.

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Recognition exemptions

Elect not to apply the requirements of AASB 15 to:

- Short-term licences (class of licence) and
- Licences for which the transaction price is of low value (licence by licence).

If choose to apply the exemption then recognise revenue either upfront or straight line basis (or other systematic basis).

No exemption available for licence with variable consideration.

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AASB 1058 Income of Not-for-Profit Entities

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Steps in AASB 1058

Recognise asset at fair value

- Cash - recognise as a financial asset under AASB 9 *Financial Instruments*
- Leased assets – recognise a right-of-use asset under AASB 16 *Leases*
- Property, plant and equipment (PPE) - recognise under AASB 116 *Property, Plant and Equipment*, and
- Intangible assets – recognise under AASB 138 *Intangible Assets*

Recognise credit on balance sheet

- Contribution by owners (AASB 1004)
- Revenue or contract liability (AASB 15)
- Lease liability (AASB 16)
- Financial instrument (AASB 9)
- Provision (AASB 137).

Excess is recognised as income

- One exception for assets controlled by the entity

Exception to general rules in AASB 1058:
Acquisition or construction of an asset controlled by the entity

Requires the entity to use the financial asset to acquire or construct non-financial asset to identified specifications	Does not require the entity to transfer a financial asset, good or service to the transferor	Obliges the entity to refund amounts if the financial asset is not applied in accordance with the terms of the transfer

- Not a contract with a customer since no transfer of goods / services
- Liability to be recognised for fair value of asset transferred (cash) less related amounts.
- Income recognised as asset constructed.

Peppercorn (below market value) leases

An asset has been received for significantly less than fair value principally to enable the entity to further its objectives – apply the steps in AASB 1058

Day 1:

1. Recognise the asset at fair value (debit)	The asset which has been received is a right to use asset (with restrictions)
2. Recognise related credits on the balance sheet	There may be a small lease liability which is recognised at its present value.
3. Compare the debit and the credit and take the excess credit balance to profit and loss.	There is likely to be a significant credit balance to be taken to profit on day 1 (or retained earnings on adoption of AASB 15.

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Peppercorn (below market value) leases continued

Over the life of the lease:

Depreciate the right of use asset	Dr: Depreciation expense Cr: Right of use asset

If the lease term changes then reassess the right to use asset.

Volunteer services

Local Government, Government departments, GGS and whole of Governments	Other not-for-profit entities

• Volunteer services recognized in the financial statements if:
  • The services would have been purchased had they not been donated and
  • The fair value can be measured reliably.
	• If volunteer services can be measured reliably then other not-for-profit entities can choose to recognize in the financial statements.

Rates and annual charges

Ordinary rates
Special rates
Annual charges (pursuant to s496, 496A, 496B, 501 & 611)
Domestic waste management services
Water supply
Sewerage services
Drainage
Stormwater management services charge
Waste management services (not domestic)
Coastal protection
Section 611 charges
Waste levy
Other (specify if material)

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User charges and fees

User charges	Planning and building – regulatory
Domestic waste management services	Inspection fees
Water supply services	s603 certificates
Sewerage services	Registration fees
Drainage services	Parking fees
Waste management services (not domestic)	Caravan parks
Other (specify if material)	Leisure centre
	Child care
Fees	Aerodrome
Private works	Aged care
RMS works (state roads not controlled by council)	Quarry
Building services – other	Other (specify if material)

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Other revenues

Reversal of revaluation decrements previously expensed
Parking fines
Other fines
Recycling income (non-domestic)
Rental income:
– Investment property
– Other property
Insurance claims
Commissions and agency fees
Computer bureau income
Sales of inventories
Other (specify if material)

With the modified approach – Entities need to also present the current year figures using the ‘old’ standards

Modified approach	Mostly AASB 15	AASB 111 / AASB 118 / AASB 1004	1 July 2019

Key messages

Account for the substance of the transaction

Percentage of completion as we know it no longer exists

Don't assume your current accounting treatment will comply with these standards

Contracts / agreements may need to be rewritten – think about where you are the grantor

Think about existing systems

Not just a finance team issue

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To do list for Councils

- Education
- Accounting policies
- Accounting systems
- Collation of information
- Communication

Accounting Issues

Purpose of the session

- Raise accounting concerns so all parties understand current issues
- Clarification from OLG / Audit Office / Technical, where possible
- Brainstorm possible outcomes, e.g.:
  - Code clarification
  - Education
  - AASB project
  - Specific Council discussions

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To get started…

- Valuations – restrictions on assets
- Depreciation
- Rural Fire Service assets

- Open forum – what else?

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Accounting Code

Purpose of the Code / role of OLG in relation to financial reporting

- Inform you of significant changes for 30 June 2018 and the process undertaken
- Obtain feedback – positive and negative
- Provide us with some potential changes to be considered in future updates
- Comments about future format and education processes relating to the release

Remember

Code is not there to necessarily provide all solutions to accounting issues – Councils are required to apply judgement and estimates to their specific balances and transactions in compliance with Accounting Standards.

New format

New format of the Code is mandated

- Position of accounting policy within the specific note is not

Deleted notes:

- Renumber remaining notes
- Delete sub-sections if not relevant
- If balance / transaction is not relevant then don’t include information
- If balance exists but is not material - consider level of detail being disclosed.

Future of the Code

- Process for releasing the Code
  - Webinars?
- What will the Code look like in the future?
- Further comments?

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Where to from here?

- Prepare workplan for update #27 and beyond to include education, policy and guidance on :
  - new accounting standards
  - reporting on infrastructure assets – valuations, depreciation, asset classes etc.
  - performance measures i.e. Note 28 and Special Schedule 7.
  - Review of
    - Special Purpose Financial Statement and Schedule Schedules
    - Appendices - accurate and relevant

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Where to go to for help?

OLG Accounting Practice webpage

http://www.olg.nsw.gov.au/strengthening-local-government/supporting-and-advising-councils/accounting-practice

Email: code@olg.nsw.gov.au

Contact details for OLG

Laura Love, Senior Policy Officer
– 02 4428 4178
laura.love@olg.nsw.gov.au

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The End

We thank you for your participation in this session
and wish you a safe journey home

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