



Tasmanian
Audit Office

Client Information Session

Accounting standards update

Launceston

7 June 2018

Hobart

8 June 2018

Rod Whitehead, Ric De Santi, Jeff Tongs, Stephen Morrison



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Client Seminar

Accounting standards update

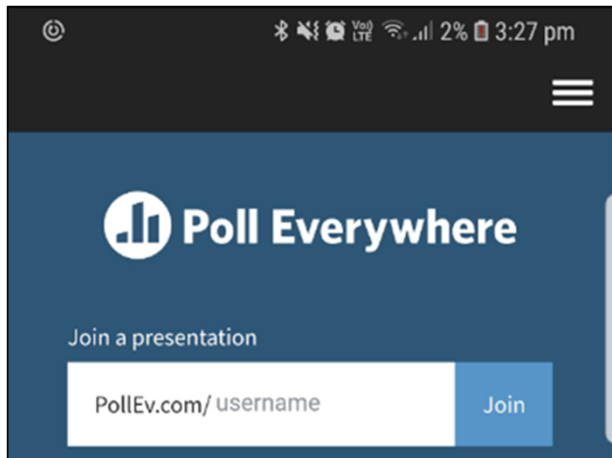
Welcome and opening comments

Overview

Rod	Ric	Stephen	Jeff
10.05 - 10.35	10.35 - 11.10	11.30 - 12.15	12.15 - 1.00
<p>Accounting issues:</p> <ul style="list-style-type: none"> Control vs Joint Control Debt – covenants, short-term facilities Restricted cash Development incentives 	<p>Accounting for Property, plant and equipment</p>	<p>New Standards:</p> <ul style="list-style-type: none"> AASB 16 <i>Leases</i> 	<p>Changes for 30 June 2018 and New Standards:</p> <ul style="list-style-type: none"> Changes to AASB 107 <i>Statement of Cash Flows</i> AASB 15 <i>Revenue</i> AASB 1058 <i>Income of not-for-profit entities</i> AASB 9 <i>Financial Instruments</i>



Morning Tea - 11.10-11.30



Web Browser: Pollev.com/TAO144

App username: TAO144



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Accounting issues

Treasurer's Instructions – departure from Accounting Standards

Control vs joint control

Debt

Restricted cash

Development incentives

Rod Whitehead

Auditor-General

Accounting issues

Treasurer's Instructions – departure from accounting standards

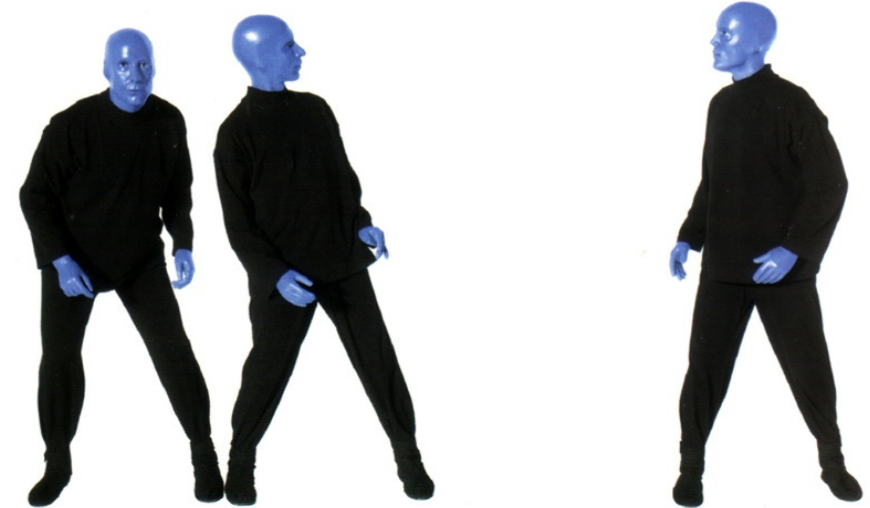


- Conflict between accounting standard and Treasurer's Instruction – which to apply?
- Can management depart from an accounting standard?
- Is there a fair/acceptable accounting framework?
- What is the impact on our audit opinion

Accounting issues



Joint control



Control
or

Poll



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Accounting issues

Control or joint control?

- Assess control
 - Exposed, or have rights, to variable returns
 - Affect those returns
 - Power over the arrangement (existing rights that give the current ability to direct the relevant activities)
- Assess joint control
 - Contractually agreed sharing of control
 - Rights and obligations
 - Unanimous agreement

Accounting issues

Is it a current or non-current liability?

1. Original loan term > 12 months, but repayable within 12 months of YE
2. New long term agreement after year end but before signing the FS
3. Entity has discretion to roll/refinance debt for *at least twelve months after* the YE under an existing loan facility
4. Loan agreement breach before YE, but lender waived action after YE but before signing FS
5. Loan facility has termination date “not before the next review date”, is subject to annual review with next review 30 June 2019



Accounting issues

Restricted cash:

- AASB 107 - an entity shall disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the group
- what level is “significant”?
- what does “not available for use” mean?
- does the restriction exclude the item from being classified as cash or cash equivalent?



Accounting issues



Development incentives

- Lease incentives – AASB 117 (AASB 16)
 - Concessional loans – AASB 139
 - Future payment obligations – AASB 137
 - Remission of fees, taxes, rates – AASB 118, AASB 1004, (AASB 15, AASB 1058)
-
- Revenue recognition (recipient) – AASB 118, AASB 1004, (AASB 15, AASB 1058)
 - Grants and government assistance – AASB 120, AASB 1004

Important reminders

- An accountable authority responsible for the operations of a State entity is to advise the Auditor-General, in writing, before the end of the relevant financial year of all subsidiaries of the State entity (section 21(1))
- A State entity, or an audited subsidiary of a State entity, is to have an accountable authority (section 14(1))
- An accountable authority, as soon as possible and within 45 days after the end of each financial year, is to prepare and forward to the Auditor-General a copy of the financial statements for that financial year which are complete in all material respects (section 17(1))
- This includes submission of financial statements for subsidiary entities



QUESTIONS



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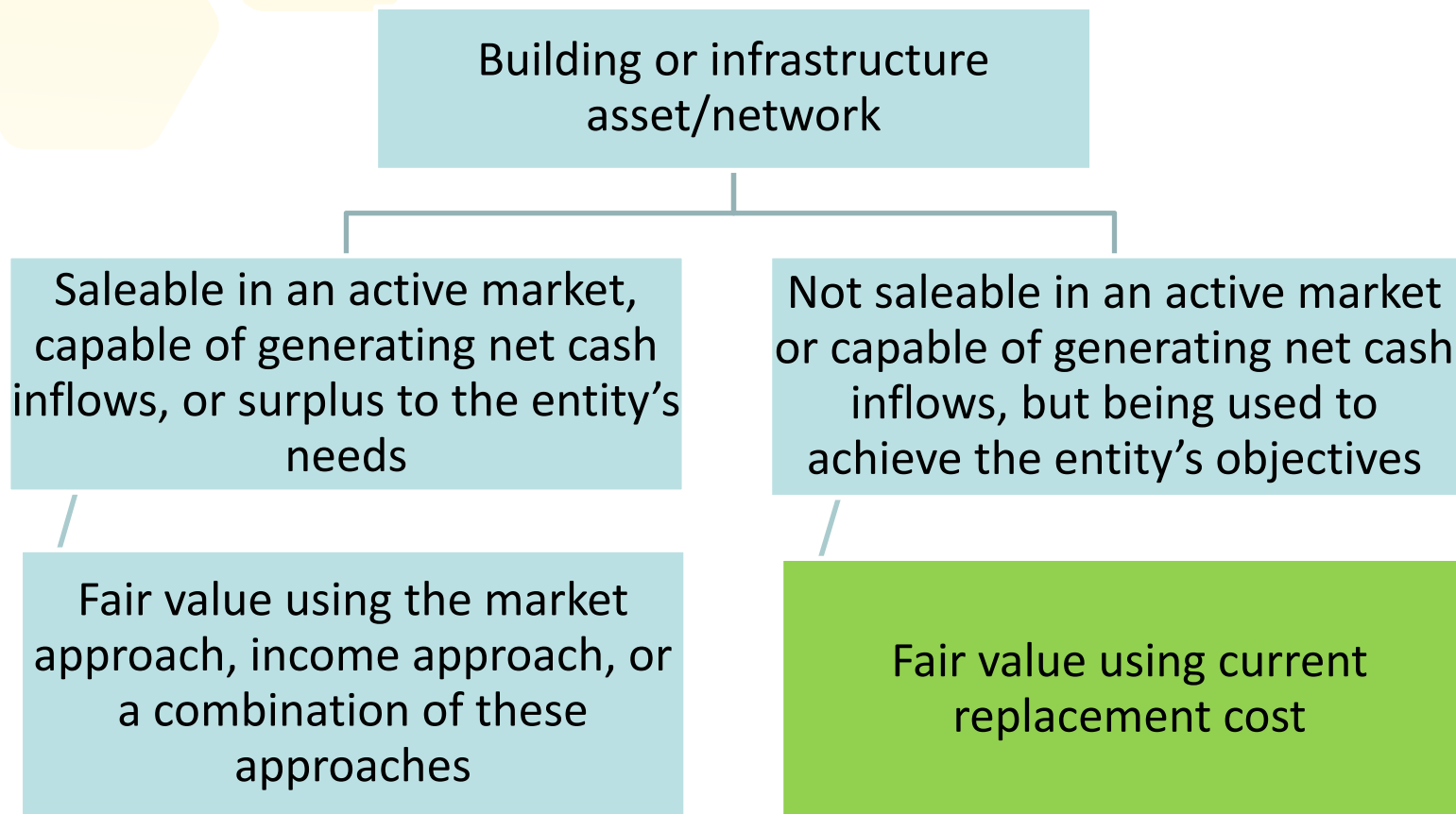
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Property, plant and equipment

Valuation
Impairment
Common challenges

Ric De Santi
Deputy Auditor-General

Appropriate valuation approach



For your infrastructure assets still in use, what valuation approach do you use?

Poll

Depreciated
Replacement Cost

A large red 'X' is superimposed over the text 'Depreciated Replacement Cost'. A green arrow points from this box down to the 'Current Replacement Cost' box.

Current
Replacement Cost

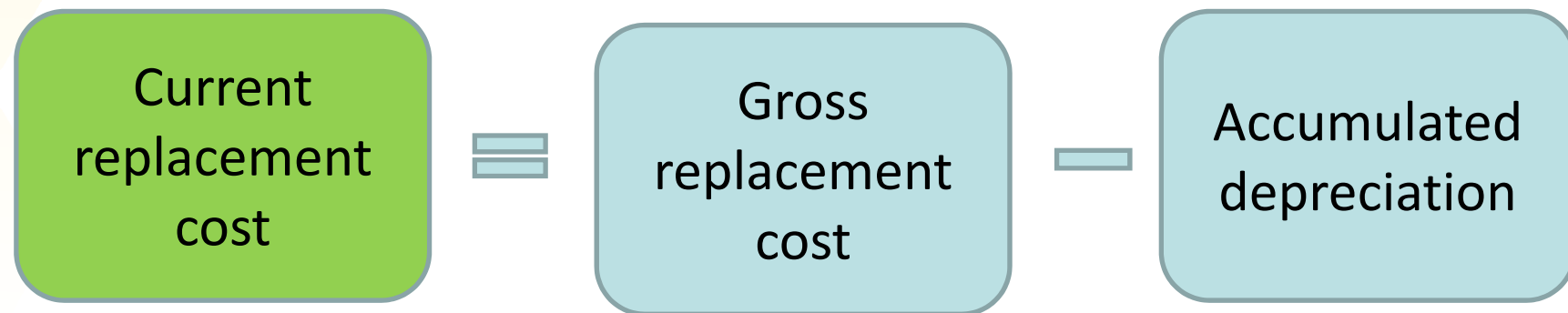


Current replacement cost

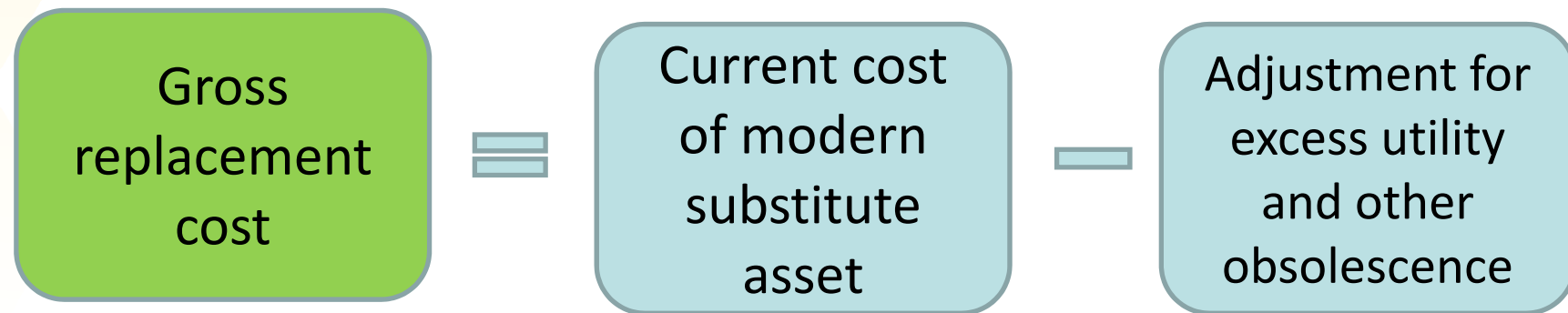
Defined by AASB 13:

- a valuation technique that reflects the amount that would be required to currently replace the service capacity of an asset.
- *Current replacement cost is the cost to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence.*

Overview of current replacement cost



Deriving gross replacement cost



Current cost of modern substitute asset

Current cost
of a significant
part of the
modern asset

=

Number of
units

×

Unit rate

The table below provides two simple examples of units and unit rates.

Asset	Significant part	Number of units (a)	Unit rate (b)	Current cost (a x b)
Hospital building	External doors	10 doors	\$4 000 / door	\$40 000
Sealed Road	Bitumen seal spray	50 000 m ²	\$4.50 / m ²	\$225 000

Example

Sources for unit rate development:

- actual labour and materials costs for recent projects undertaken by the entity
- schedules of rates supplied by developers on handover of assets
- schedules of rates provided by tenderers for capital works
- advice from a panel of industry experts.
- unit rates published by external experts such as the Roads and Transport Alliance for roads, Cordell's or Rawlinson's
- other benchmark data from nearby or otherwise comparable entities.

Excess utility normally takes two forms.

Type of utility	Description	Examples	Adjustment required
Quantity of outputs (asset size)	<p>In many cases, entities would choose to replace their assets with a larger version, or be legally required to do so.</p> <p>In these cases, the gross replacement cost needs to reflect the service capacity of the existing asset, rather than the desired service capacity.</p>	<p>An entity would replace a four-lane road with a six-lane road today due to increased usage during peak periods.</p> <p>Changes in construction codes for hospitals require the number of bathroom facilities per patient, resulting in the modern building being larger than the existing building.</p>	<p>In practice, valuers usually take size differences into account by applying the unit rates of modern components to the quantities of the existing asset.</p> <p>Ideally, the difference in size between the modern substitute asset and the existing asset will not be so great as to have a material impact on the unit rates for each component (e.g. due to economies of scale). Otherwise, adjustments for economies of scale are required.</p>
Quality of outputs (asset standard)	<p>The quality of infrastructure often increases over time due to factors such as technology advances and enhancements to construction codes.</p> <p>It is inappropriate for entities to base gross replacement cost on these modern standards if they do not represent the utility that is currently in place.</p>	<p>Improved air conditioning systems.</p> <p>Increased mobility support requirements such as ramps and lifts for modern buildings.</p>	<p>If the modern substitute asset has a component that is absent in the exiting asset, the adjustment amount is the full amount of that component.</p> <p>If a component in the existing building has less utility than the modern component, the adjustment amount is any surplus in the current cost of the modern component over the existing component.</p> <p>Where current prices are not available for the gross utility provided by the existing asset, an estimate is required.</p>





Impairment

A light blue rounded rectangle with the word 'Impairment' inside. A large red 'X' is drawn over the rectangle. A green arrow points from the bottom right of this rectangle to the top left of the 'Obsolescence' rectangle below it.

Obsolescence



Type of obsolescence	Description	Example	Adjustment required for example
Functional (technological) obsolescence	<p>Functional obsolescence includes:</p> <ul style="list-style-type: none"> • Superseded design, technology or materials • Over-engineering <p>The modern substitute asset is typically devoid of functional obsolescence. Adjustments for excess utility capture functional obsolescence.</p>	For infrastructure, examples of functional obsolescence additional to that captured by adjustment for excess utility are rare.	In this example, entities should base the gross replacement cost on the smaller sized substitute.
Economic (external) obsolescence	<p>When external influences such as changes in population, income levels or the regulatory environment cause a permanent decrease in demand for related services.</p> <p>A hypothetical willing market buyer would only be prepared to incur the costs required to meet an asset's expected future peak level of demand.</p>	A recently constructed school that is of a modern standard, but whose required maximum future capacity has decreased because of the unexpected closure of a mine that was the major employer in the region.	The substitute asset is a smaller sized school sufficient to cater for the revised estimates of future student numbers. Therefore, adjustments are needed to gross replacement cost to reflect the decrease in size required.



Case study

Impact of excess utility and obsolescence on gross replacement cost

The modern fire protection system is more expensive than, and twice as effective as, the system in place for an existing building. We can view this difference equally as excess utility (greater outputs) and functional obsolescence (outdated technology). In addition, the entity would replace the existing building today with a building half its size as it has permanent excess capacity because of economic obsolescence.

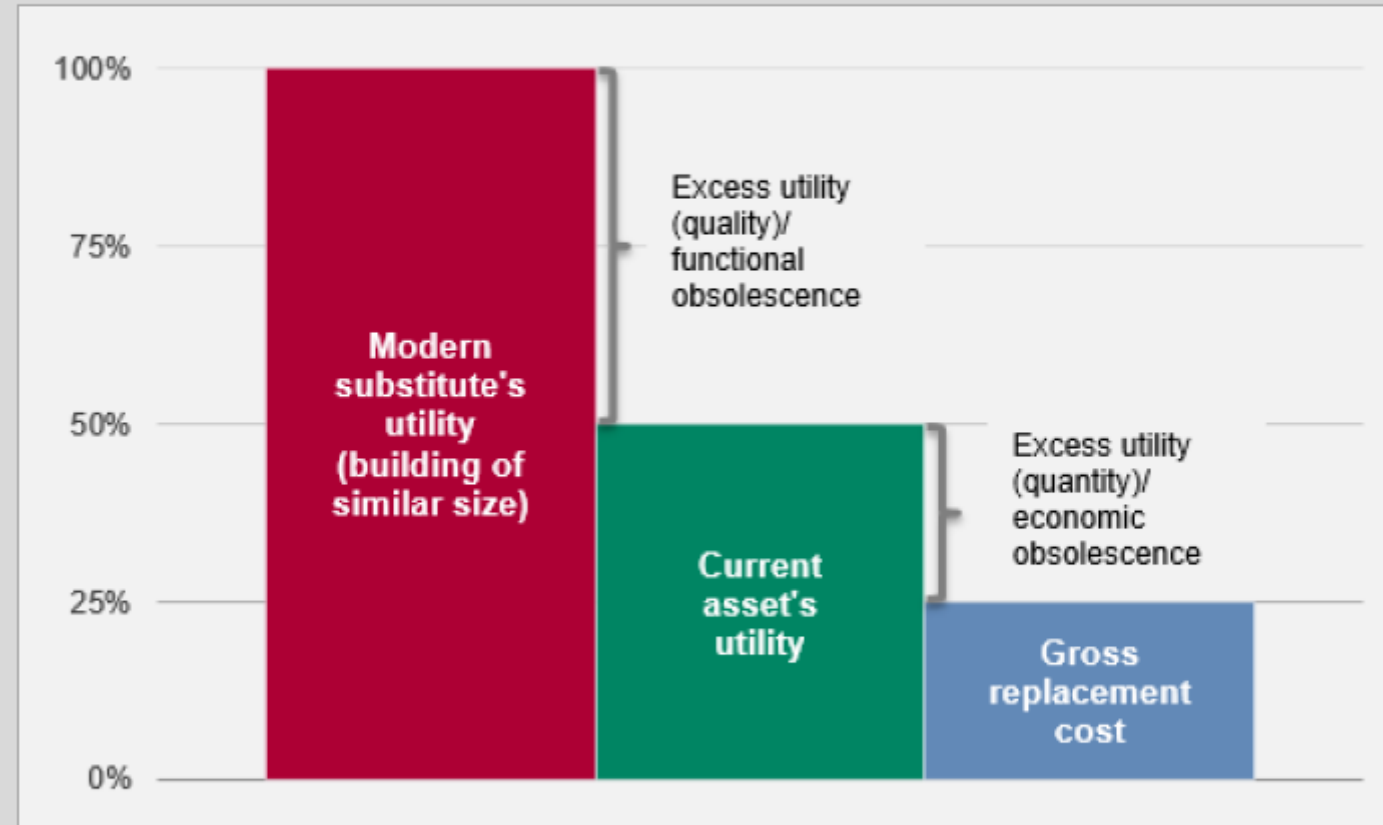
Poll

What impact, if any, will there be on GRC?

Case Study

Impact of excess utility and obsolescence on gross replacement cost

The modern fire protection system is more expensive than, and twice as effective as, the system in place for an existing building. We can view this difference equally as excess utility (greater outputs) and functional obsolescence (outdated technology). In addition, the entity would replace the existing building today with a building half its size as it has permanent excess capacity because of economic obsolescence.



The gross replacement cost is the utility embodied by the existing asset that is required to meet future demand. This is less than the modern asset because it is inappropriate for an entity to recognise value that it has not acquired or does not require. Entities should not recognise an increase in asset value and subsequent revaluation gain because the requirements of building codes have increased, unless they have actually implemented the new requirements.

Calculating accumulated depreciation

- The current replacement cost valuation approach involves making adjustments for obsolescence.
- Although obsolescence is broader than depreciation, it still includes depreciation.
- The physical deterioration portion of obsolescence is essentially its accumulated depreciation.

Example

Public infrastructure with constant service capacity:

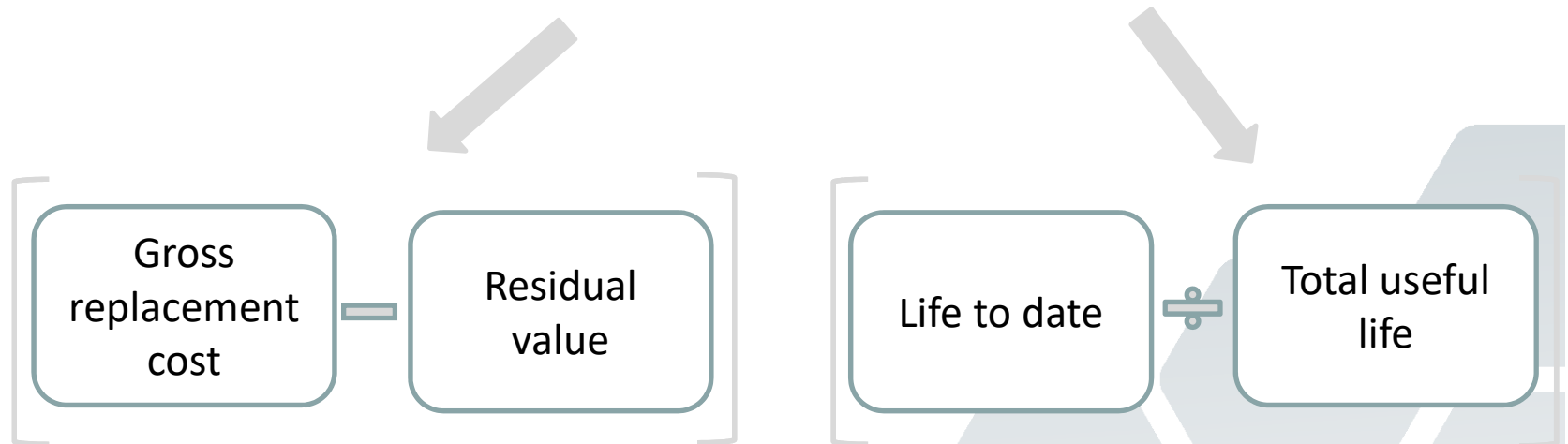
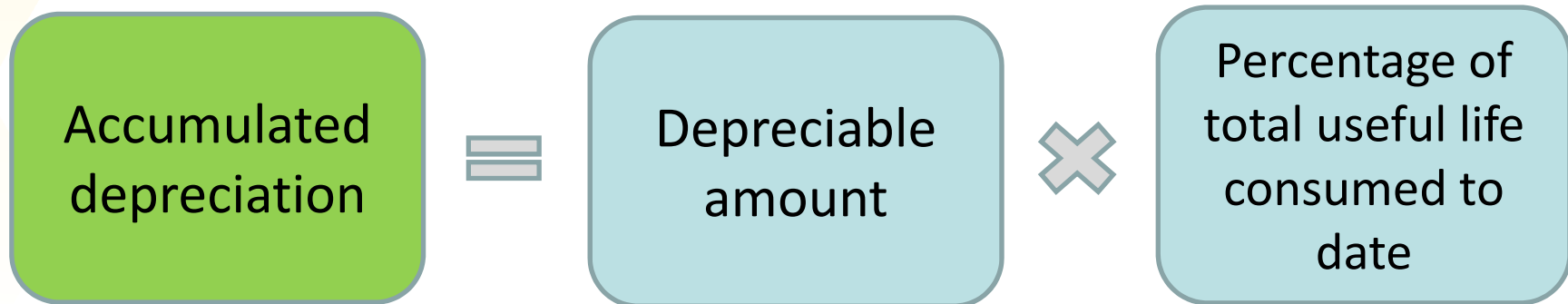
specialised buildings, whose potential to accommodate students, patients, or prisoners, for example, is the same from one year to the next.

roads and bridges, which have the same level of traffic capacity, regardless of whether they are in new condition or moderate condition.

drains, whose benefit is being in place to provide a service when it rains, and whose value does not increase or decrease based on the expected rainfall.



Calculating accumulated depreciation



Obsolescence

Type of obsolescence	Description	Impact in estimated total useful life
Physical deterioration	Loss of value due to physical deterioration arising from normal usage.	If a component's physical condition is worse than expected for its age, this is an indicator that a reduction in total useful life is required.
Functional (technological) obsolescence	Functional obsolescence includes: <ul style="list-style-type: none">▪ superseded design, technology, or materials▪ over-engineering.	Entities sometimes replace assets ahead of schedule to attain the extra utility provided by the modern substitute asset, even though the existing asset is in good condition. In these cases, total useful life of the existing asset reduces.
Economic (external) obsolescence	When external influences such as changes in population, income levels or the regulatory environment cause a permanent decrease in demand for related services.	<p>Like functional obsolescence, entities may decide to replace assets that are in good condition because of economic obsolescence.</p> <p>The opportunity to make savings in operating and maintenance costs through replacement with a smaller asset is one reason for such decisions. This obsolescence results in a reduction in the total life of the existing asset.</p>



Example

How changes in estimated total useful life affects current replacement cost

Input	Fair value— Original total life	Fair value— Revised total life
Gross replacement cost (a)	\$1 200 000	\$1 200 000
Residual value (b)	\$0	\$0
Life to date (c)	30 years	30 years
Total useful life (d)	60 years	→ 50 years
Percentage of total life consumed to date (e) <i>formula: b / c</i>	50%	60%
Accumulated depreciation (f) <i>formula: $(a - b) \times c$</i>	\$600 000	\$720 000
Current replacement cost <i>formula: $a - f$</i>	\$600 000	\$480 000
Annual depreciation expense <i>formula: a / d</i>	\$20 000	\$24 000

Common challenges

1. Determining the valuation approach with consideration for highest and best use
2. Identifying the significant parts of an infrastructure asset
3. Deciding whether to use greenfield or brownfield costs
4. Reviewing useful lives and residual values
5. Utilising condition ratings appropriately
6. Reviewing and documenting valuation assumptions and inputs



Common challenges #1

Determining the valuation approach with consideration for highest and best use

Scenario	Example	Highest and best use for this example	Valuation approach in this example
Asset no longer required to achieve the entity's objectives	A rural train line that has been closed due to reduction in long-term freight forecasts	Scrap	Market approach
An active market exists for an asset or a group of assets	A building that is currently used to achieve the entity's objectives, for which a competitive rental market exists	Rental property	Combination of the market approach and the income approach
No recent sales of similar assets, but a private sector operator could make a profit by purchasing the assets at their current replacement cost	Water and sewerage assets that are capable of being operated at a profit	Open tender sale of water and sewerage business	Income approach

Conclusion

Current use is the highest and best use when:

1. the entity is using the asset or group of assets to achieve its objectives
2. there are no recent sales of similar assets
3. a private sector operator would be unable to make a profit from a group of assets purchased at their current replacement cost.

Where an asset meets all of the above criteria, fair value is measured using current replacement cost.



Common challenges #2

Identifying the significant parts of an infrastructure asset

Meaning of ‘an item of property, plant and equipment’

Example

An item of infrastructure:

Asset class	Example
Specialised buildings	Each building and potentially each extension
Roads	Each road, or each road segment

For horizontal networks such as roads and pipes, best practice is to base segments on each combination of the following factors:

- common characteristics—(e.g. differentiating hill sections from flat sections) as segments with different characteristics have different gross replacement costs
- life to date—(e.g. differentiating stretches replaced due to flooding from older stretches) as segments with a different ages have different accumulated depreciation
- total useful life—(e.g. differentiating parts with shorter useful lives due to the local environment) as segments with different total lives have different accumulated depreciation.



Case Study

Importance of separately accounting for significant parts

A hospital building constructed 20 years ago has a total gross replacement cost of \$100 million. The estimated total useful life of the structure of the building is 80 years. The entity's asset revaluation surplus for the buildings class exceeds \$10 million.

The following table shows how fair value and depreciation expense are different depending on whether the entity accounts separately for a part with a gross replacement cost \$10 million (10 per cent) and a total life of 20 years. If not accounted for separately, the part's useful life is that of the buildings, being 80 years. If accounted for separately, its useful life is 20 years.

Input	Outcome when the component is <u>not</u> separately accounted for	Outcome when the component is separately accounted for
Gross replacement cost (a)	\$10 000 000	\$10 000 000
Residual value (b)	\$0	\$0
Life to date (c)	20 years	20 years
Total useful life (d)	80 years	20 years
Percentage of total life consumed to date (e) <i>formula: c / d</i>	25%	100%
Accumulated depreciation (f) <i>formula: (a - b) x e</i>	\$2 500 000	\$10 000 000
<i>Current replacement cost</i> <i>formula: a - f</i>	\$7 500 000	\$0
Annual depreciation expense <i>formula: a / d</i>	\$125 000	\$500 000

If the entity had not depreciated the part separately, a revaluation decrease of \$7.5 million is required in year 20 when the entity replaces the part. The entity would need to make the adjustment against comparatives if the failure to value the part separately was an error and the impact was material.

When the entity replaces the \$10 million part in year 20, an addition is required for the renewal cost and a disposal is required for removal of the original part.

The part's fair value after the entity replaces it is \$10 million. If the entity did not account for the part separately and expensed the replacement costs rather than capitalising them, the revaluation adjustment it recognises is a \$2.5 million increment instead of the correct treatment of a \$7.5 million decrement, and a \$10 million addition. While the difference in these treatments does not affect property, plant and equipment, it does result in errors for expenses (overstated by \$10 million) and asset revaluation surplus (overstated by \$10 million), which has a flow-on effect for the net operating result.

Significant parts (Components)

Example

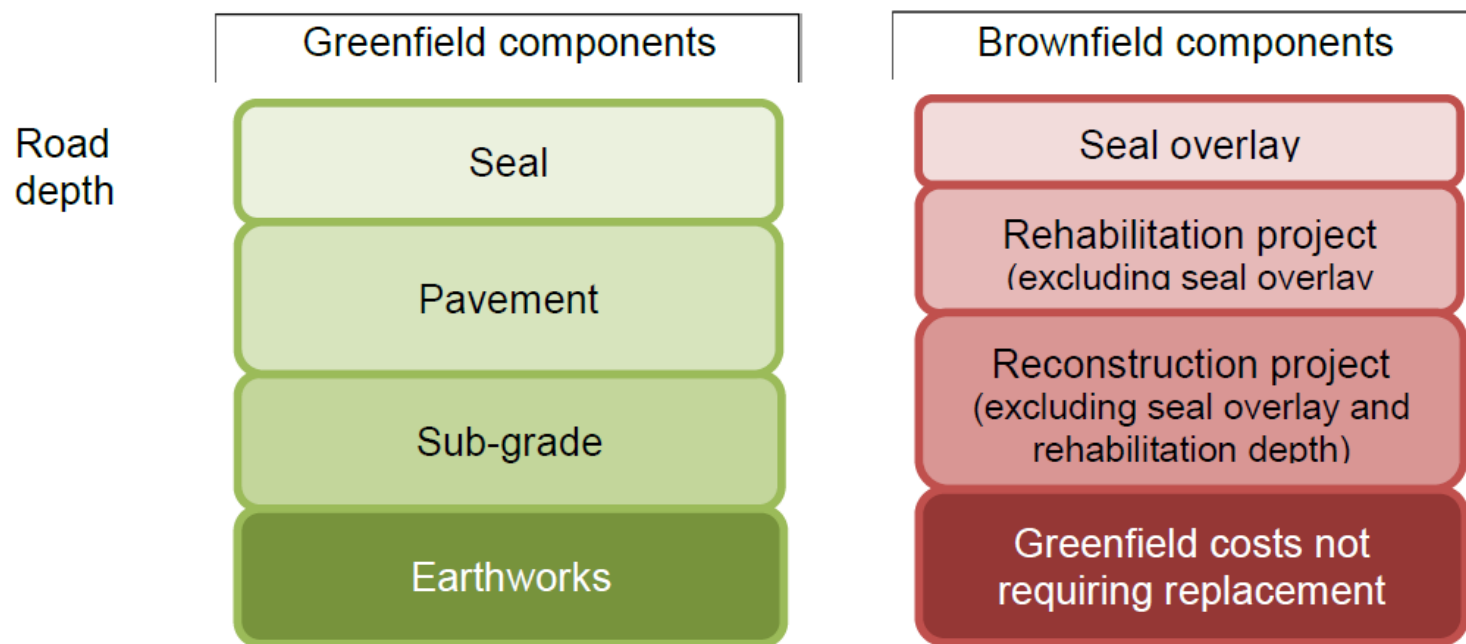
Benefits of separately recording each part with a gross replacement cost above the capitalisation threshold are:

- better alignment with valuations, which are based on the parts of the asset requiring replacement over its life cycle. Among other things, this allows entities to more meaningfully analyse valuation movements
- reliable calculation of depreciation expense
- simpler accounting for additions, and related disposals when parts are replaced
- higher quality information available for asset management, such as more detailed knowledge of the expected timing and cost of replacing parts
- avoids the complexity around adjusting average depreciation rates when the entity replaces a part.



Common challenges #3

Deciding whether to use greenfield or brownfield costs



Road type	Project type (greenfield components impacted)	Example project	Description
Gravel	Rehabilitation (pavement)	Re-sheeting	Place new granular (gravel) pavement over original pavement.
Sealed	Seal overlay (seal)	Spray (chip) seal	Place a single coat bitumen surface over the existing sealed surface.
	Rehabilitation (seal and pavement)	Granular overlay	Repair pavement failures. Place new granular (gravel) pavement over original pavement. Apply new bitumen surface.
		Dig out	Dig up seal and part of pavement. Mix in a chemical stabilisation agent (typically cement) into the existing granular pavement to improve pavement strength.
		In situ stabilisation	Repair pavement failures. Place a single coat bitumen surface over the existing sealed surface.
	Reconstruction (seal, pavement and sub-grade)	Reconstruction	Replacement of existing material with all new material in the current location.



Tips

1. Brownfield is usually best for the parts of the asset that have shorter lives, as it is uneconomic to replace these components in a greenfield context unless the whole asset is due to be replaced in a greenfield location.
2. A greenfield based solution is required for components with unlimited lives, as brownfield rates are not applicable for these components.
3. The sum of the components should not exceed greenfield in total, because current replacement cost should be based on the minimum amount required to replace an asset's service capacity with a substitute asset.

Consider points

When using brownfield costs:

- exclude incidental costs incurred on other assets
- large revaluation adjustments in the year of acquisition are unusual and require investigation
- virtual componentisation may be required (refer to section 2.2.2.1 and the supplementary document for roads).

Common challenges #4

Reviewing useful lives and residual values

Consider points

For determining nominal useful lives, consider:

- the number of years it will take to replace this component type for the entire network based on recent or forecast annual funding
- historical average life for disposed assets
- design lives
- estimates used by other entities in the industry
- relationships between components (i.e. it is reasonable for an entity to estimate that they will replace components evenly over the asset life cycle)





Example

The table below provides a checklist for identifying assets whose useful lives differ materially from their nominal lives, and some examples of high-level responses. Entities should have detailed supporting documentation for each consider point.

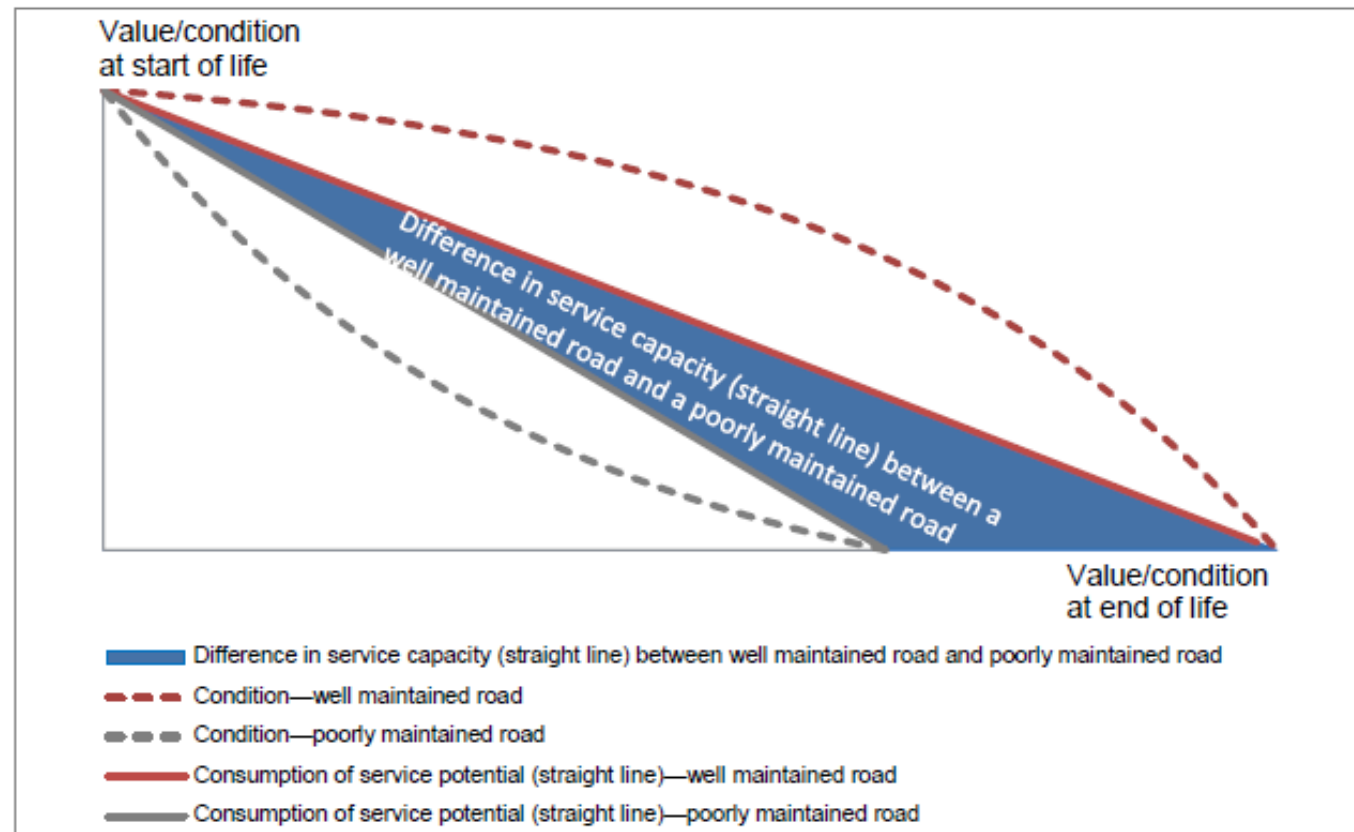
Consider point	Example summary of analysis performed
Assets that have passed their nominal lives.	<p>A report of assets with a life to date greater than the nominal life was extracted. A useful life was set for each listed asset based on life to date plus a remaining life, which was estimated based on condition ratings and that asset management plan—refer to detailed documentation filed at...</p> <p>We have updated the asset register with these new lives.</p>
<p>Correlation with condition:</p> <ul style="list-style-type: none"> assets whose current condition suggests that they will require replacement before they reach the nominal life. assets whose current condition suggests that the entity can defer their replacement. 	<p>Maintenance staff update condition ratings for all assets on a five-year rolling basis, and record the latest condition rating in the asset register. For each unit rate category, we graphed condition ratings against lives to date for each asset to identify those with unusually low or high condition ratings relative to age. Significant outliers that were not addressed above were re-inspected, and their total lives adjusted in the asset register as appropriate. Refer to the detailed documentation filed at...</p>
<p>Assets requiring early retirement despite being in good condition because of:</p> <ul style="list-style-type: none"> obsolescence legal limits (lease agreements or licence conditions). <p>Correlation with the asset management plan:</p> <ul style="list-style-type: none"> inconsistencies between budget for renewals and gross replacement cost of assets whose lives are due to expire over the budget period assets specifically identified for replacement earlier than the nominal life assets that will pass their nominal lives within the period covered by the plan, but are not planned for replacement during that period. 	<p>We are not aware of any assets whose useful lives are subject to legal limits. We do not plan to replace any assets early due to obsolescence.</p> <p>An updated asset management plan was endorsed by the audit committee in the current year and is filed at... This plan identified specific assets needing replacement during the plan period on pages XX to XX. We have updated the asset register with these lives.</p> <p>A report of assets due to expire over the term of the asset management plan was extracted. The gross replacement cost of these assets was [higher/lower] than the budget for renewals. We corrected this mismatch by [deferring/bringing forward] the useful lives of the assets closest to expiry date, and smoothing the lives for the remaining assets—refer to the detailed documentation filed at...</p>

Suggested steps for reviewing useful lives:

1. By 31 March (for a 30 June year end):
 - review nominal lives
 - review for exception for nominal lives
2. Provide evidence of the review to the auditor
3. Upon agreement on lives:
 - update accumulated depreciation per section 1.3
 - update useful lives for future depreciation calculations
4. Around year end, perform a high-level review for significant changes since the detailed review.

Common challenges #5

Utilising condition ratings appropriately



Use of conditions assessments

Case study

Comparison of condition rating adjustments and time-based adjustments for physical deterioration

Scenario

A road pavement is currently five years old and its condition rating has not changed since construction, which is consistent with original expectations. Useful life on commissioning was 50 years.

Issue

What percentage adjustment, if any, is required at year five for physical deterioration?

Options

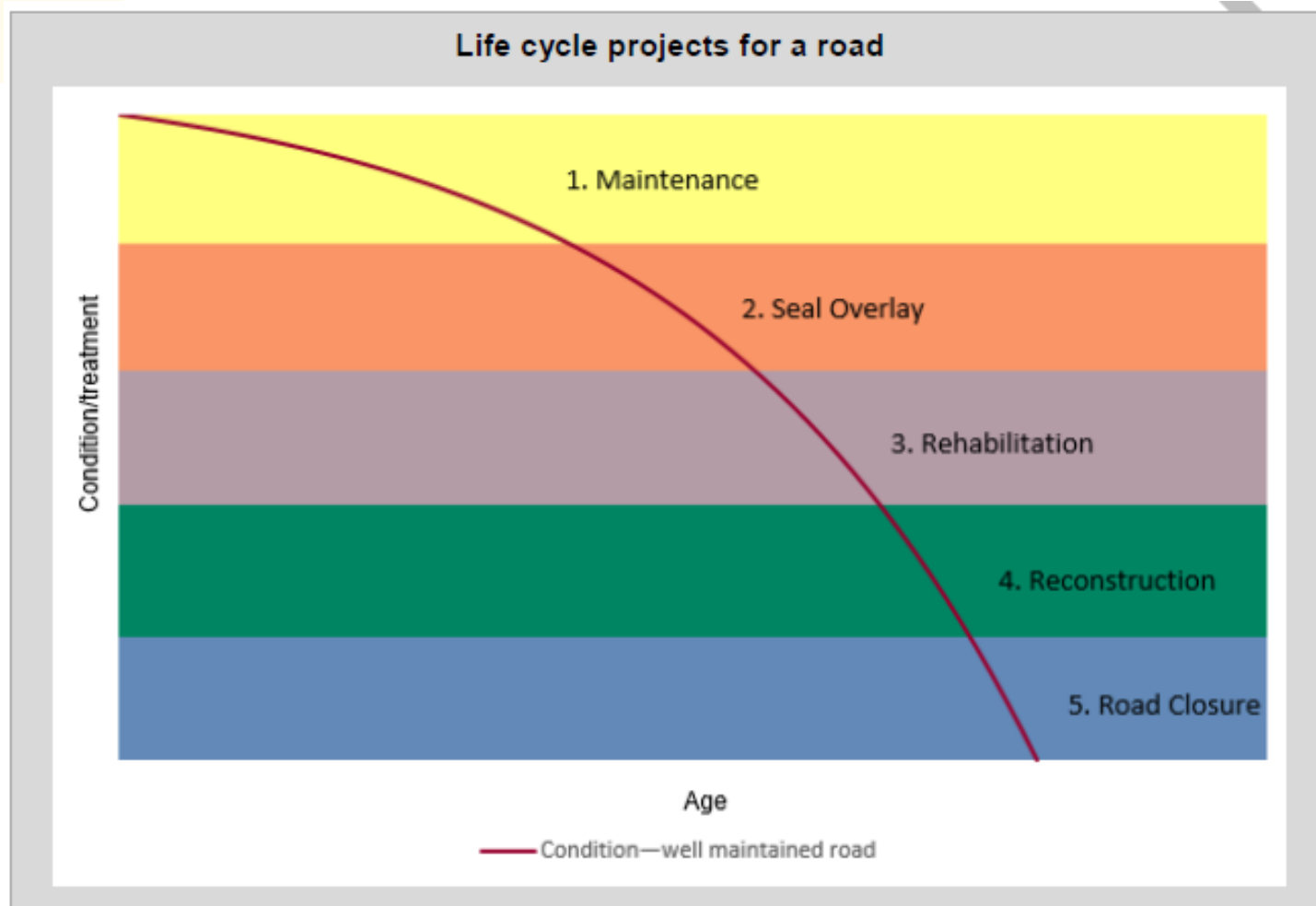
- 0 per cent, because there has been no change in condition rating.
- 10 per cent, based on a straight-line formula of life to date (five years) divided by total estimated life (50 years).

Analysis and conclusion

It is illogical to suggest that pavement experiences nil physical deterioration over a five-year period. Equally, it is unrealistic to expect that a hypothetical willing market buyer would pay full gross replacement cost for a road pavement that is five years old. Therefore, the straight-line approach (option 2) provides a more reliable estimate of the adjustment for physical deterioration.

Poll

Depreciation



Common challenges #6

Reviewing and documenting valuation assumptions and inputs

- General principles for documenting valuations
- Expectations for documenting an annual review of valuations

What to do between comprehensive revaluations?

In years between comprehensive revaluations, entities should review for changes in:

- highest and best use
- the modern substitute asset/functional obsolescence
- demand for the asset/technical obsolescence
- componentisation/parts planned for replacement
- use of greenfield or brownfield costs
- construction cost indices
- useful lives, including asset management plans/budgets and condition assessments
- residual values.

Other matters

Asset recognition/de-recognition

Found assets	➤ Prior period error
Land transfers	➤ Asset recognised at fair value in income statement
Scrapped or demolished assets	➤ Derecognised
Damaged assets	➤ Reduced useful life or derecognised
Assets held for sale	➤ Reclassify, market valuation
Intangible assets	➤ AASB 138





QUESTIONS



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Client Information Session
Accounting standards update

Morning Tea



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New Standards

AASB 16 Leases

Stephen Morrison

Assistant Auditor-General Financial Audit

What is a lease?





Definition

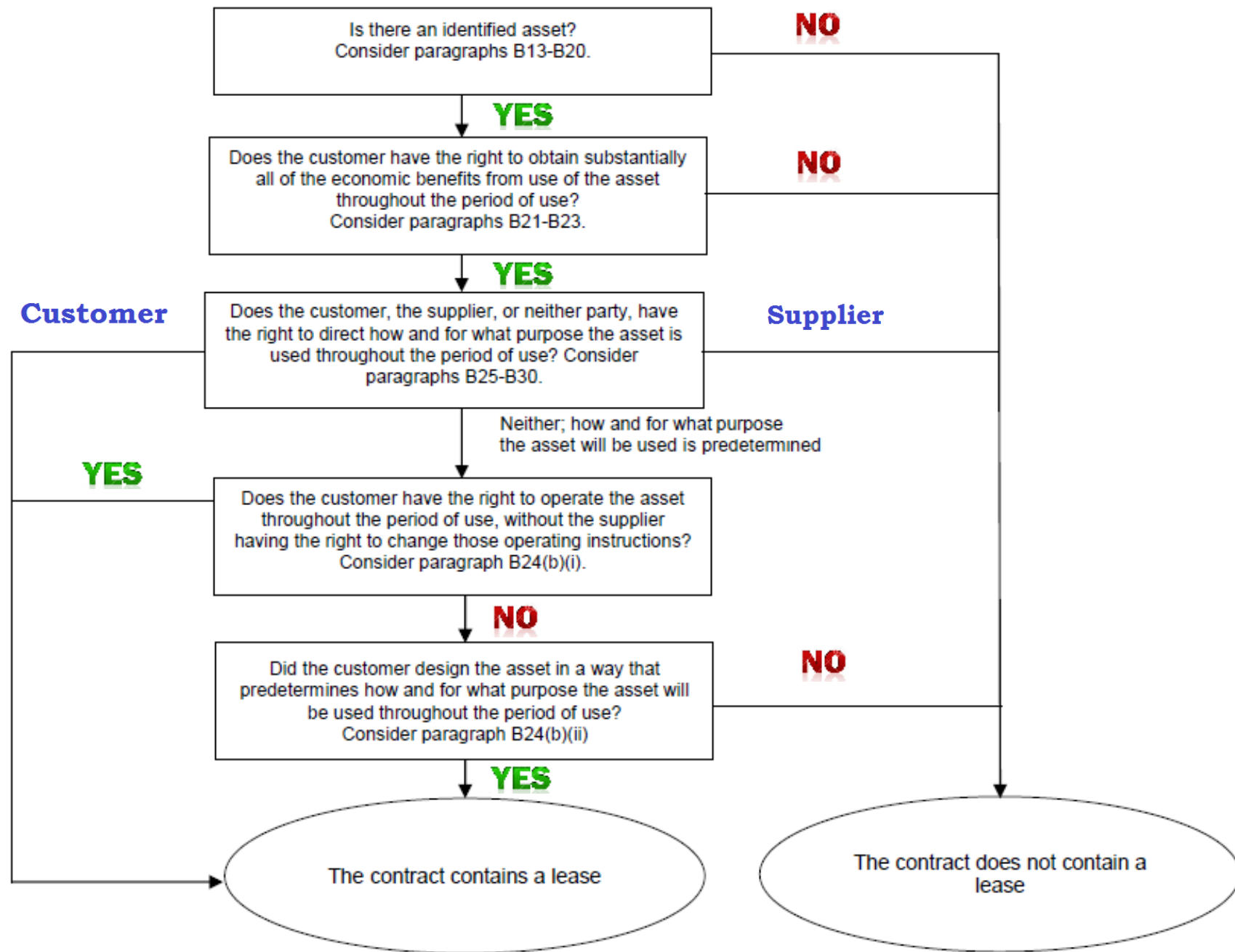
A Lease - is a 'contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration'

All contracts create rights and obligations



So what does this mean?

- Need to review contracts to identify potential leases
- Contracts have varying rights and obligations
- Does the contract:
 - Have an identifiable asset (there may be more than one)
 - Provide the right for the customer to obtain all of the economic benefits from using the asset over the period of the contract
 - Provide the customer with the right to direct how and what purpose the asset is used for
- If yes – generally considered to be a lease
- If no – contract unlikely to be a lease



Exercise – Is it a lease?

- Example 1 – Motor vehicle (substitution rights)
 - Supplier has right to change vehicle at any time during the term of the contract

Poll – Is it a lease?

- Example 2 – Land (decision-making rights)
 - Supplier has rights to decide what can be grown on the land

Poll – Is it a lease?

- Example 3 – Maintenance and operating practices
 - Supplier specifies how a lathe is to be operated and maintained
 - These do not impact on the ability to obtain economic benefits

Poll – Is it a lease?

Exclusions

Not required to be included
in lease liabilities

- Leases of low-value assets (approx. \$7,500)
- Short-term assets (<12 months)

Excluded from
lease liabilities

- Variable lease payments
- Optional payments (not reasonably certain)

- Disclosure requirements apply (p53)

Multi Lease Contracts

- Must consider that each RoUA is a separate lease component.
- Allocate consideration to each separate lease component:
 - Recognise a separate lease for each lease component with an observable stand alone price.
 - Where no observable stand alone price, bundle and recognise components as a single lease component.

Exercise – Lease components no.1

- Net lease for office accommodation
 - Rental \$300 psm per month
 - Outgoings \$80 psm per month

What is recognised as part of the lease liability?

Poll

Exercise – Lease components no.2

- Gross lease for office accommodation
 - Total rental \$380 psm per month
 - Outgoings not separately identifiable

What is recognised as part of the lease liability?

Poll

Lessee Model

- **Assets & liabilities on the balance sheet**, initially measured at the present value of unavoidable lease payments
- **Amortisation** of lease **assets** and **interest** on lease **liabilities** over the lease term
(Assets – typically straight-line basis)
- **Separate** the total amount of cash paid into:
 - **Principal** portion (presented within financing activities)
 - **Interest** (either operating or financing activities).



Presentation Impacts

Statement of Financial Position

<ul style="list-style-type: none">• Right-of-use asset• Lease liability	Either by:	<ul style="list-style-type: none">➤ Separate line items, or➤ In the relevant Notes and link
--	------------	--

Income Statement

- Interest expense on the lease liability
- Depreciation charge on right-of-use assets

Statement of Cash Flows

<ul style="list-style-type: none">• Cash payment on the principal	➤ Financing Activity
<ul style="list-style-type: none">• Short-term, low-value and variable lease payments not included in liability measurement	➤ Operating Activity
<ul style="list-style-type: none">• Interest portion	➤ Apply AASB 107 <i>St' of Cash Flows</i>

Recognition – Lease Liability

- Initial recognition at commencement date:

Present value of:

the lease payments not paid

+

Residual value guarantees

-

Lease incentives receivable

+

Exercisable Options (reasonably certain)

Recognition – Right to Use Asset

- Initial recognition:

Lease liability as calculated previously

+

Lease payments made before commencement date

-

Lease incentives received

+

Initial direct costs of Lessee

+

PV Cost of removal and make-good at end of the lease



Example 1 - Recognition

- Information available
 - Office accommodation – Commencing 1 July 2020
 - Term 5 years with a 5 year option expected to be exercised
 - Rent \$48,000 per annum
 - Outgoings \$12,000 per annum
 - Financing rate 6%
 - Lease incentive (fit-out) \$20,000
 - Received \$15,000
 - Receivable \$5,000
 - Legal costs for lease \$2,000
 - Lease payment made 1 June 2020 - \$4,000
 - Residual value guarantee \$Nil
 - Make Good \$20,000

Example 1 - Recognition

- What is the value of the Lease Liability (ignoring the PV calculation)
- What is the value of the Right to Use Asset?

Example 1 - Recognition

- Liability

- + Rent \$236,000 ($\$48,000 \times 5$ years less \$4,000 paid)

- + Option \$240,000 ($\$48,000 \times 5$ years)

- + Residual value \$0

- Lease Incentive Receivable (\$5,000)

- Total \$471,000** (to be discounted to Present Value)

- Asset

- + Lease liability \$471,000 (to be discounted to Present Value)

- + Lease paid before commencement \$4,000

- Lease Incentive Received (\$15,000)

- + Legal Fees \$2,000

- + Make Good \$20,000 (to be calculated and discounted under AASB 137)

- Total \$482,000**



Example 2

- Assumptions:
 - 3 year lease.
 - Lease payments \$50,000 p.a.
 - Effective interest rate 6%.
 - Lease payments made at end of period.



Example 2

- At start - RoUA and lease liability \$133,651.
- At the end of each period - RoUA amortisation \$44,550
- For each lease payment - cash \$50,000 and:
 - Year 1; Interest expense \$8,019 & principal repayment \$41,981
 - Year 2; Interest expense \$5,500 & principal repayment \$44,500
 - Year 3; Interest expense \$2,830 & principal repayment \$47,170

Totals **\$16,349** **\$150,000** **\$133,651**

Example 2

Opening Journal

DR Right-of-use-asset
CR Lease Liability

Year 1	
133,651	
	133,651

Yearly Journal

DR Interest Expense
DR Lease Liability
CR Bank

Year 1	
8,019	
41,981	
	- 50,000

Year 2	
5,500	
44,500	
	- 50,000

Year 3	
2,830	
47,170	
	- 50,000

Dr Amortisation Expense
Cr Accumulated Amortisation

44,550	
	- 44,550

44,550	
	- 44,550

44,550	
	- 44,550

Statement of Financial Position

DR Right-of-Use-Asset
Cr Accumulated Amortisation
($\$133,651 / 3 \text{ years} = \$44,550$)

133,651	
- 44,550	
89,101	

133,651	
- 89,101	
44,550	

133,651	
- 133,651	
-	

CR Lease Liability
DR Lease Liability

	- 133,651
41,981	
- 91,670	

	- 91,670
44,500	
- 47,170	

	- 47,170
47,170	
-	

Example 2

Statement of Comprehensive Income

Interest Expense
Amortisation Expense

Year 1
8,019
44,550
52,569

Year 2
5,500
44,550
50,050

Year 3
2,830
44,550
47,380

Statement of Cash Flows

Interest Expense
Financing Cash Flow *(Principal Repayment)*

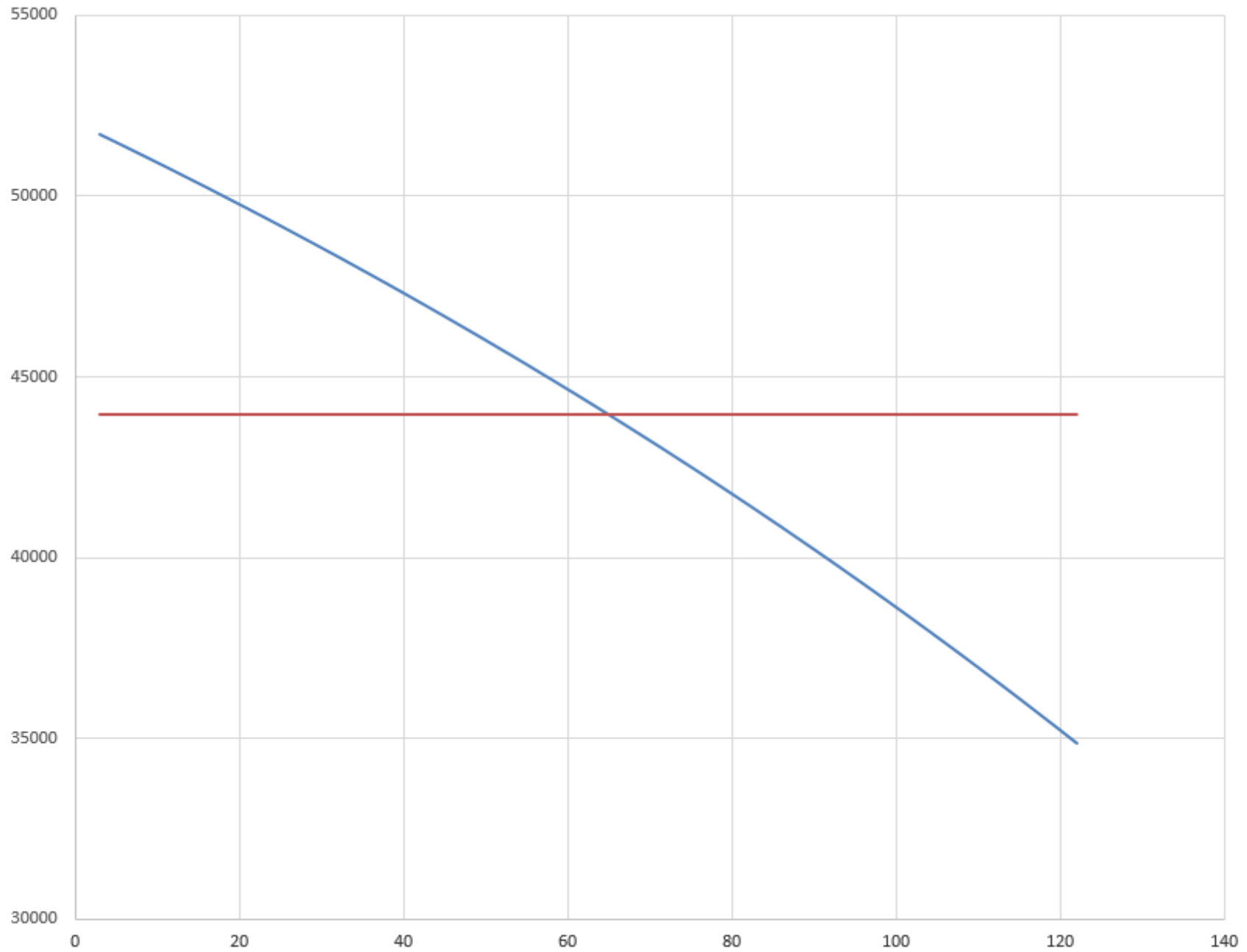
8,019
41,981
50,000

5,550
44,500
50,000

2,830
47,170
50,000



Lease Expenses



Other Considerations

- CPI and other rate increases
- Changes to leases during lease period (modifications)
- Peppercorn Leases
- Present value calculations - determine effective interest rate (may differ between leases for similar or like assets)
- Review disclosure requirements

Lease re-measurement

(for example, CPI rent increase)

	1-Jul-10		1-Jul-11
1-Jul-10	1,000,000		
1-Jul-11	1,000,000	1-Jul-11	1,020,000
1-Jul-12	1,000,000	1-Jul-12	1,020,000
1-Jul-13	1,000,000	1-Jul-13	1,020,000
1-Jul-14	1,000,000	1-Jul-14	1,020,000
1-Jul-15	1,000,000	1-Jul-15	1,020,000
1-Jul-16	1,000,000	1-Jul-16	1,020,000
1-Jul-17	1,000,000	1-Jul-17	1,020,000
1-Jul-18	1,000,000	1-Jul-18	1,020,000
1-Jul-19	1,000,000	1-Jul-19	1,020,000

Changed rent

NPV 5% 1-Jul-10 7,848,186

NPV 5% 30-Jun-11 7,231,114

\$144,623

7,375,737



Lease re-measurement

(for example, CPI rent increase)

		Asset	Liability			Asset	Liability
Opening balance	1-Jul-10	0	0		1-Jul-11	7,063,797	7,231,114
Adjustment		7,848,186	7,848,186			144,623	144,623
Adjusted opening balance	1-Jul-10	7,848,186	7,848,186			7,208,419	7,375,737
Interest			382,928				357,619
Repayments			-1,000,000				-1,020,000
Depreciation		-784,389				-802,641	
Closing balance	30-Jun-11	7,063,797	7,231,114		30-Jun-12	6,405,778	6,713,355

Lease Modifications

Eg: Lessee has 10yr lease for 2 floors office space. In year 6 an additional floor becomes available in the market.

A separate lease if both:

(Para 44)

- (a) the modification increases the scope of the lease by adding the right to use one or more underlying assets; and
- (b) Increase in consideration for the lease is commensurate with the stand-alone price of the additional RoUA to reflect the circumstances of the particular contract.

Lease Modifications

Eg. Lessee has 10 year lease for office space.

At the end of year 6 the lessee and lessor agree to amend the original lease and extend it by 4 years.

Lessee remeasures the lease liability:

- *On an 8 year remaining lease term*
- *Recognises the difference between carrying amounts of the lease (before and after), as an adjustment to the right-of-use asset*



Lease Modifications

Eg. Lessee has 10 year lease for office space.

At the end of year 6 the lessee and lessor agree to amend the original lease to reduce the office space from 2 floors to 1 floor.

Lessee remeasures the lease liability:

- Decreasing carrying amount of RoUA to reflect partial or full termination of the lease*
- Recognise any gain or loss in the profit or loss*



Peppercorn Leases (AASB 1058)

- Where a NFP lessee has a lease that at inception had significantly below-market terms, the NFP entity shall :
 - Measure the **right-of-use** asset at fair value
 - Measure the **lease liability** at the **present value of lease payments** not paid at that date
 - Recognise any related items in accordance with AASB 1058 (i.e. **the difference**)



• Crown leases may be captured

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Disclosures



- a) **amortisation** charge for right-of-use assets by class of underlying asset
 - b) **interest expense** on lease liabilities
 - c) the expense relating to **short-term** leases accounted for applying exemption. (This expense need not include the expense relating to leases with a lease term of one month or less)
 - d) the expense relating to leases of **low-value** assets accounted for applying exemption. (excluding short-term leases of low-value assets included in (c))
- (Para 53)



Disclosures (Cont.)

- e) the expense relating to **variable lease payments** not included in the measurement of lease liabilities
- f) income from **subleasing** right-of-use assets
- g) **total cash outflow** for leases
- h) **additions** to right-of-use assets
- i) gains or losses arising from **sale and leaseback** transactions
- j) the **carrying amount** of right-of-use assets at the end of the reporting period by class of underlying asset.

Key dates

- Effective reporting periods commencing 1 January 2019
 - Calendar year end – 31 December 2019
 - Financial year end – 30 June 2020
- Comparatives
 - Calendar year – 31 December 2018
 - Financial year – 30 June 2019
- If using full retrospective application
 - Opening balances needed 1 January 2018 and 1 July 2018 respectively (need to gather information now)
- Early adoption permitted, provided AASB 15 *Revenue from Contracts with Customers* is also adopted

Note Treasury may not permit early adoption

AASB 16 – *Transition*

Full Retrospective

OR

Cumulative Catch-up



how?

Apply AASB 8

- Prepare statements as if AASB 16 had always been applied
- Restate comparative information
- Disclose effect on each line item



Benefits?

Better quality of reported information in transition year



how?

- Recognise cumulative effect on initial application in opening balance of retained earnings
- Do not restate comparative information
- Consider additional reliefs
- Disclose effect of applying cumulative catch-up approach



Benefits?

Significant cost relief on transition



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Challenging Issues

- Identifying leases, particularly peppercorn leases
- Determining an appropriate discount rate
- Determining what is 'low-value'
- Higher expense upfront may be difficult to explain to users/funding providers
- Determining a 'fair value' for leases if using the FV model, particularly peppercorns
- Errors in previous accounting – e.g. make good provisions
- To date, options on how to account for lease incentives - now clarified
- May need to re-negotiate borrowing limits
- Clients may need to amend delegations to sign up to leases (previously very low for operating leases as there was no financing impact)



QUESTIONS



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Changes for 30 June 2018
and New Standards
(AASBs 107, 15, 1058, 9)

Jeff Tongs
Director Technical and Quality

Statement of Cash Flows

AASB 2016-2 *Amendment to AASB 107*

- Applies on or after 1 January 2017
 - i.e. 30 June 2018 this year!
 - Prospective

- Requires disclosure of information relating to financing liabilities and related financial assets (if any)

AASB 2016-2 – Example Reconciliation

Notes to Statement of Cash Flows

Reconciliation of liabilities arising from financing activities

Liabilities	Closing Balance 2017 \$'000	Non-Cash Changes				Cash Flows		Closing Balance 2018 \$'000
		Transfers to/(from) other Government Entities \$'000	New Leases Acquired \$'000	Change in Fair Value \$'000	Other (Specify) \$'000	Cash Received \$'000	Cash Repayments \$'000	
Leases	2,000	-	150	-	-	-	(100)	2,050
Borrowings	4,000	-	-	-	-	700	(500)	4,200
Other (Specify)	-	-	-	-	-	-	-	-
Total	6,000	-	150	-	-	700	(600)	6,250

AASB 15 Revenue from Contracts with Customers

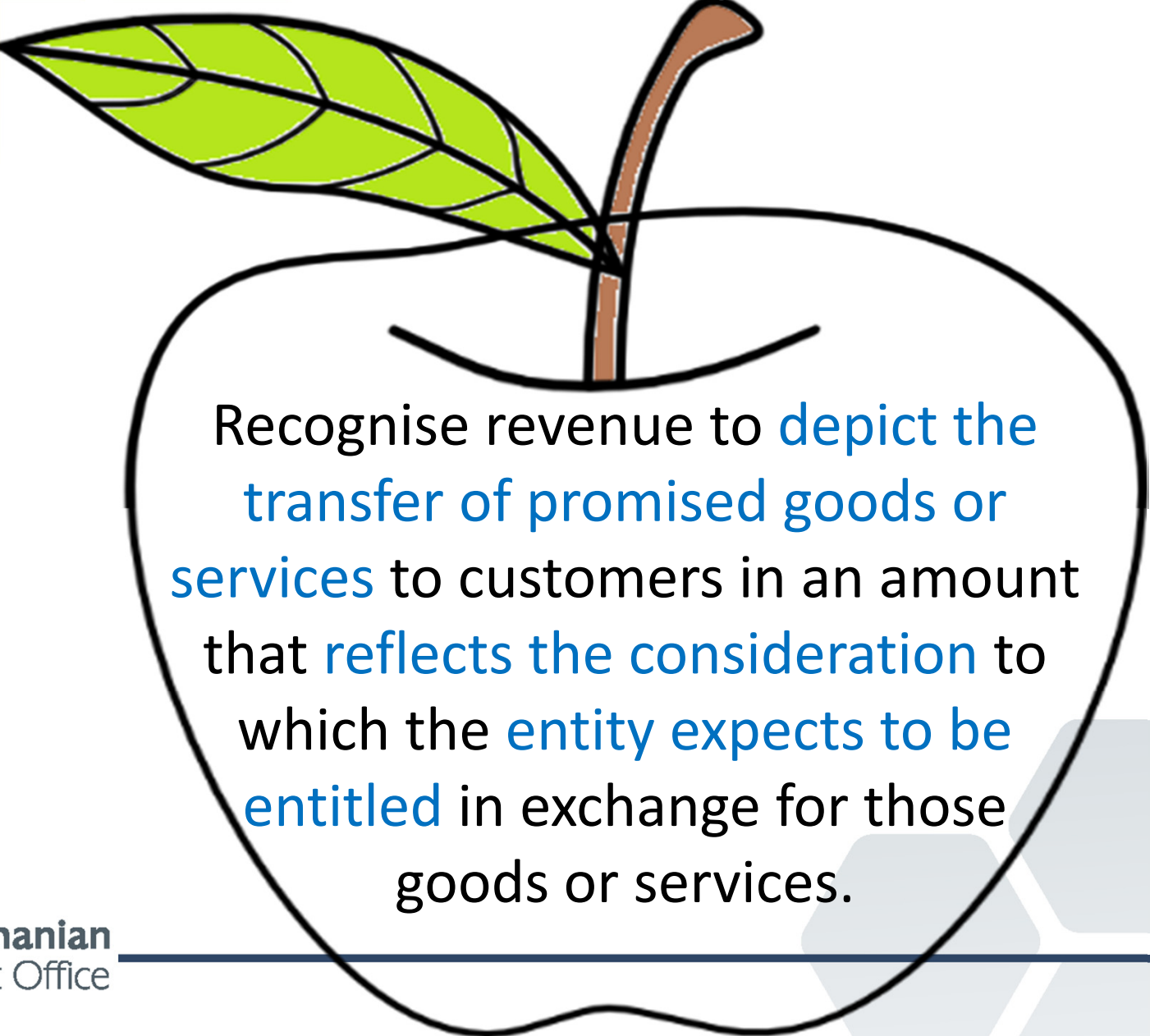


Effective Date – Year beginning on or after	30 June Year-end
1 January 2019 (Not-for-profit)	30 June 2020



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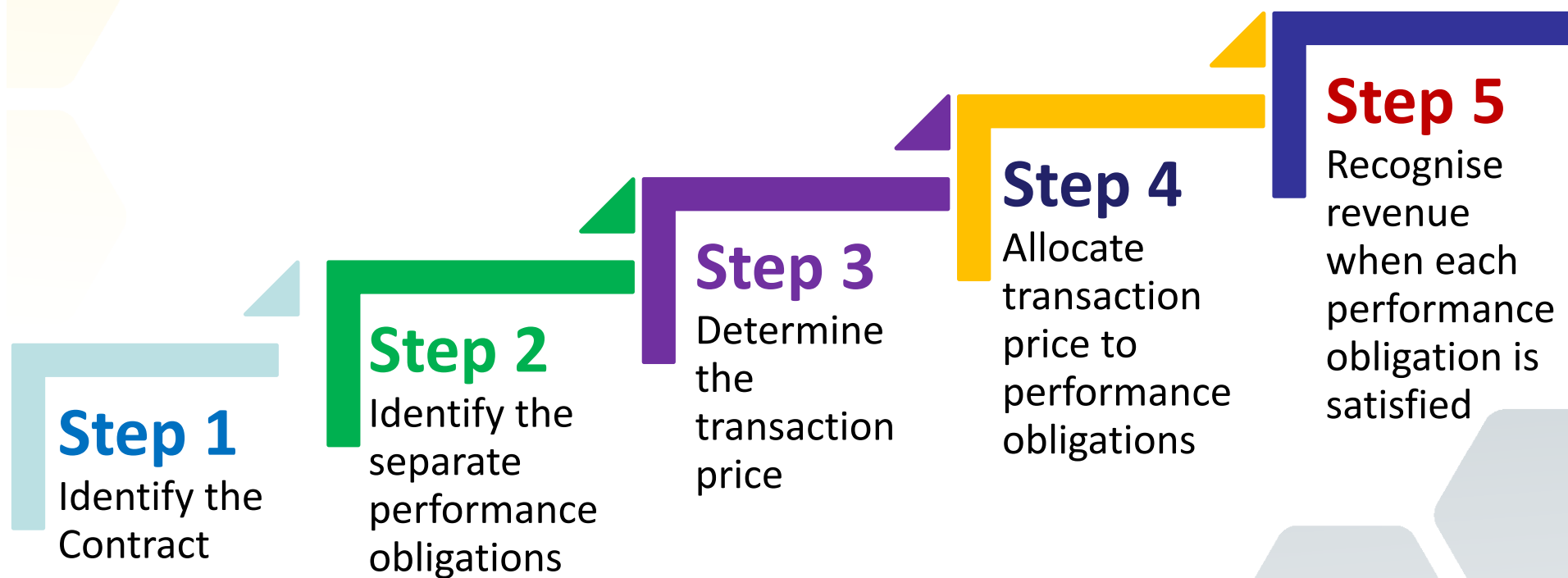
Core Principle



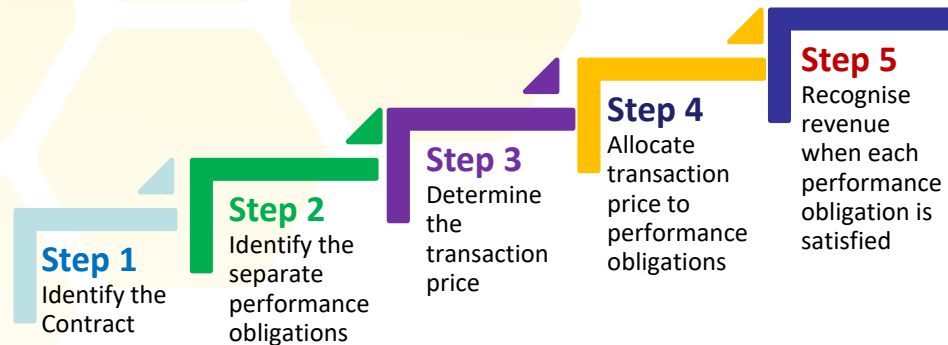
Recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.



The 5 Revenue Steps



The 5 Revenue Steps



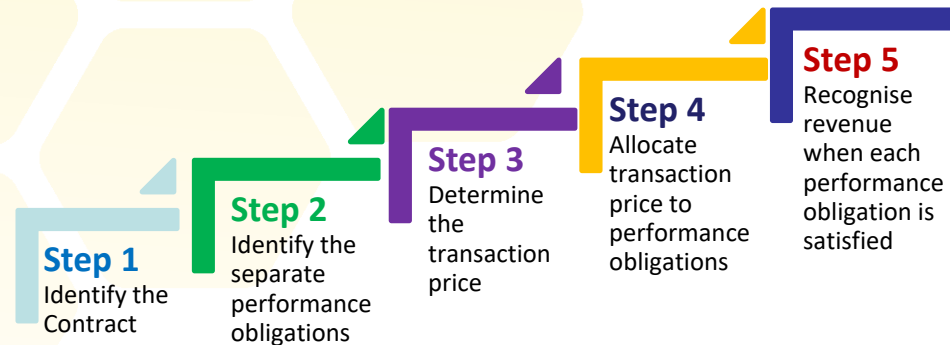
1. Identify the contract(s) with a customer

- Package with a single commercial objective
- Including contract modifications
- Principal vs. agent

2. Identify the performance obligations in the contract(s)

- What are you promising to deliver?
 - Distinct goods or services, or distinct bundle
- *Unit of account* determines when revenue is recognised

The 5 Revenue Steps



3. Determine the transaction price

- Variable consideration—bonuses, penalties, discounts, concessions
- Constraint—highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur'

4. Allocate the transaction price to the performance obligations

- Dealing with *bundles*

5. Recognise revenue as each performance obligation the is satisfied

- Over time (e.g. construction services) , or
 - Measuring progress
- At a point in time (e.g. sale of goods)

Revenue and Income Sources

- Appropriations
- Grants – Recurrent
- Grants – Special purpose
- Grants – Capital
- Fees
- Levies
- User charges
- Fees for service
- Sale of goods
- Licences
 - Right of Use
 - Right of access
- Royalties
- Performance management fees
- Contributed services
- Capital contributions / contributed assets
- Sponsorship
- Taxes
- Interest
- Dividends



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Step 1

Identify the Contract

Step 2

Identify the separate performance obligations

Step 3

Determine the transaction price

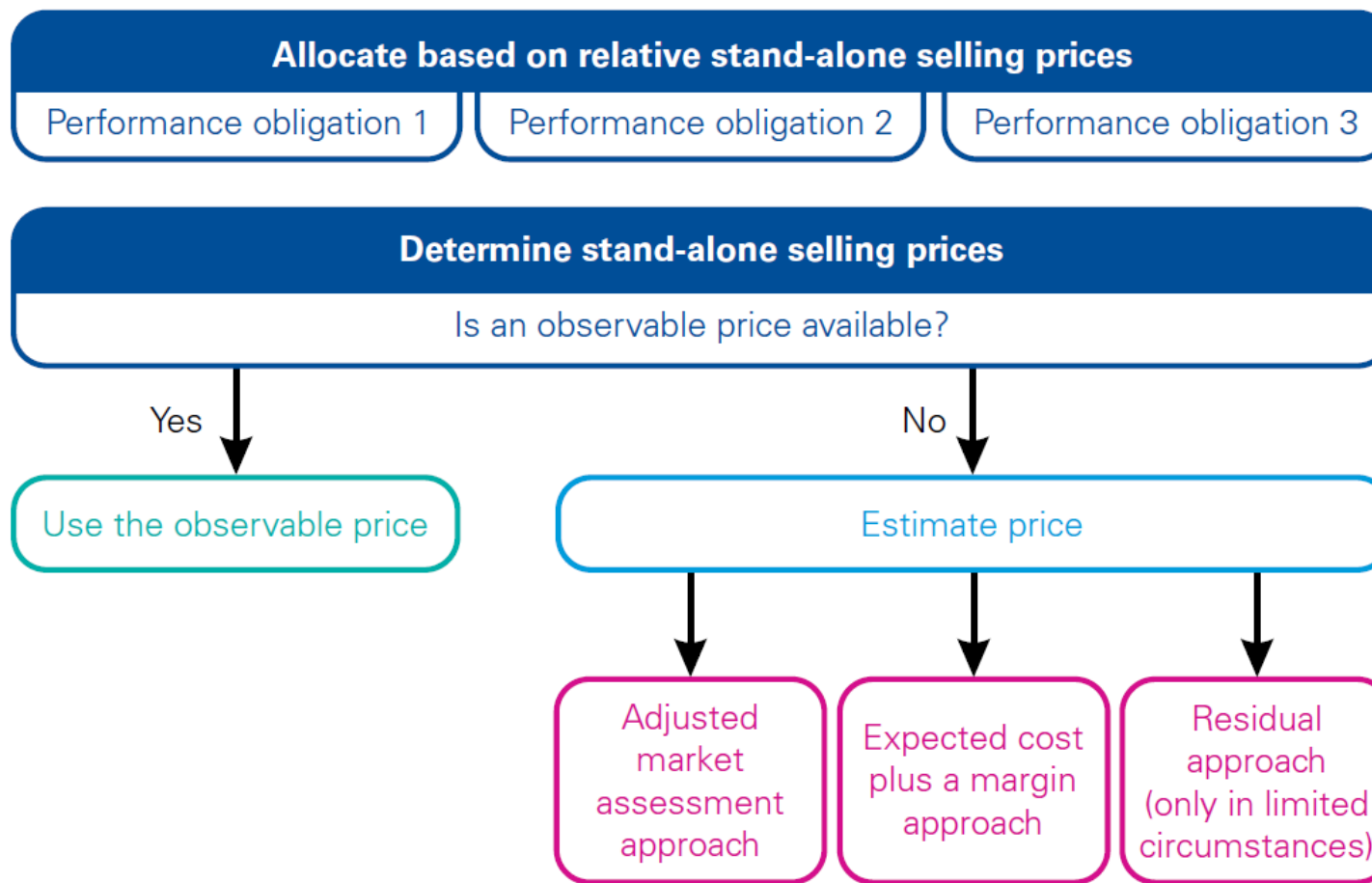
Step 4

Allocate transaction price to performance obligations

Step 5

Recognise revenue when each performance obligation is satisfied

Allocating performance obligations based on stand alone selling prices



Allocation based on a stand-alone selling price

- An entity has a contract to sell equipment, provide training and operate a helpdesk.
- Each of these has been assessed to be separate performance obligations.
- The total transaction price is \$1,200,000.

The stand-alone selling price for each distinct good or service is:

Equipment	\$750,000	50%
Training	\$150,000	10%
Helpdesk	\$600,000	40%
Total of stand-alone prices	\$1,500,000	



Allocation based on a stand-alone selling price

- The total transaction price is allocated to each service performance obligation as follows:

Equipment	Point in time	600,000	1,200,000 x 50%
Training	Over time	120,000	1,200,000 x 10%
Helpdesk		480,000	1,200,000 x 40%
Total transaction price		\$1,200,000	

Revenue Issues

- Performance obligation satisfaction
 - Point in time
 - Over time
- Dealing with bundles
- Determining and allocating stand alone price
- Principal versus agent
- Contract costs
- Options and material rights
- Breakage
- Significant financing component
- Non-cash consideration
- Payments to customers
- Discounts
- Variable components
- Refund liabilities
- Warranties
- Repurchase agreements
- Bill-and-hold arrangements
- Right of return exists
- Onerous contracts
- Licences of intellectual property
- Non-refundable up-front fees
 - Joining fees
 - Activation fees in utilities
 - Set-up/registration fees

AASB 15 – Transition is Retrospective

Two approaches allowed:

1. Fully Retrospectively application, *with some relief*
 - Need not restate completed contracts that begin and end within the same period
 - Hindsight allowed for variable consideration of completed contracts
 - Prior to application, need not disclose information on remaining performance obligations in comparatives.
2. Retrospectively with cumulative effect at date of initial application:
 - Apply the Standard to all existing contracts as of effective date and to contracts entered into subsequently
 - Recognise the cumulative effect as an adjustment to the opening balance of retained earnings



AASB 15 – Disclosures

- Key qualitative and quantitative disclosures:
 - Contract balances
 - Disaggregation of revenue
 - Costs to obtain or fulfil contracts
 - Remaining performance obligations
 - Significant judgements and changes in judgements



AASB 1058 *Income of Not-for-Profit Entities* – Objective



Establishes principles that apply to:

- (a) transactions where the consideration to acquire an asset is significantly less than fair value principally to enable the NFP to further its objectives
- (b) the receipt of volunteer services.

AASB 1058: *Income of Not-for-Profit Entities*

– Key Areas



1. Assets received below fair value
2. Transfers received to acquire or construct non-financial assets
3. Grants
4. Non-contractual statutory income
5. Peppercorn leases
6. Volunteer services

Consideration for asset
significantly less than fair value
+ furthers NFP objectives

AASB 1058 – Grants

Example:

A NFP receives a Gov't grant of \$2.4m on 31 May 20X8, which is refundable if the money is not spent in the period 1 July 20X8 to 30 June 20X9.

- It's charter is to provide counselling to victims of violence and emergency accommodation to the homeless; and
- It has an agreement that specifies the grant must be spent providing crisis counselling services for a given number of hours per week for the entire year ending 30 June 20X8. The entity expects to fulfil its promise.

AASB 1058 – Grants

Example - journal entries:

Initial recognition - 31 May X8

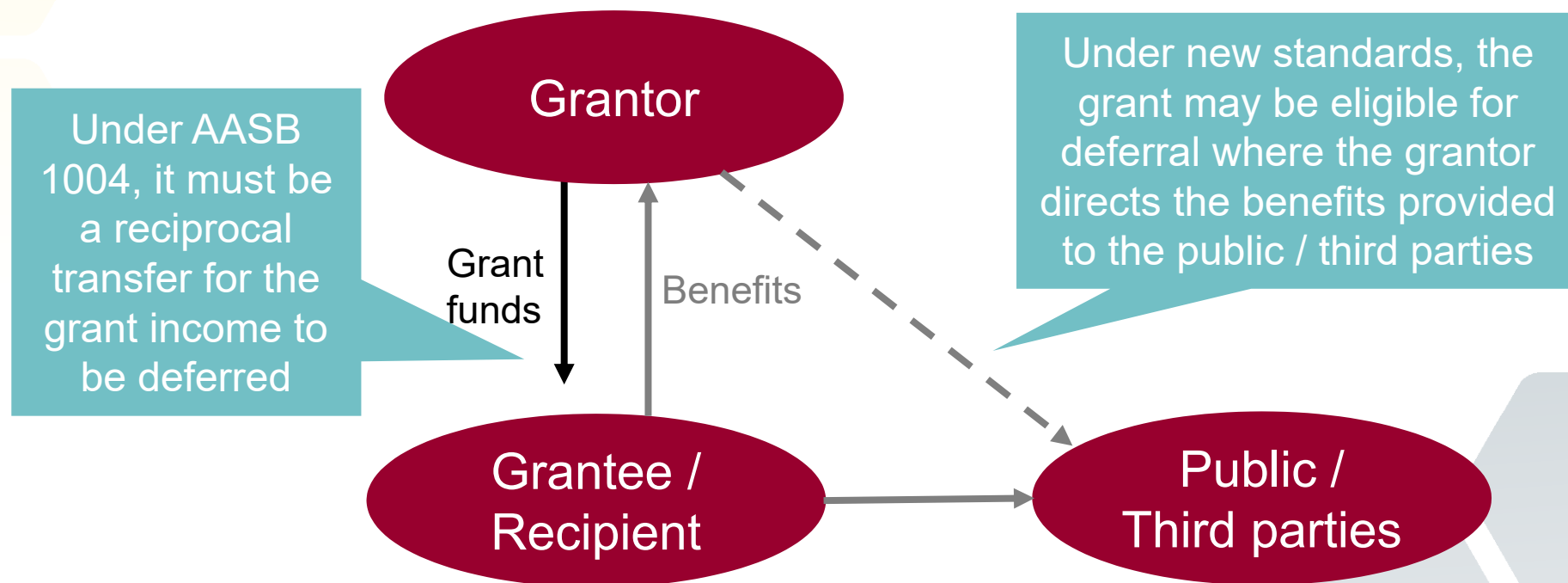
	Debit	Credit
Cash	2,400,000	
Contract Liability		2,400,000

Year 2 – 20X9

Contract Liability	2,400,000	
Expenses	2,400,000	
Cash		2,400,000
Income		2,400,000



Revenue Recognition Changes Accounting for Grant Income



AASB 1058 – Non-contractual Income arising from Statutory Requirements

- Disclose statutory income (rates, taxes & fines)
- Disaggregated into categories that reflect how the nature and amount of income are affected by economic factors
- Statutory receivables initial recognition to be part of AASB 9 (*AASB 2016-8*)
- Can be a receivable or a liability
- Example:
 - prepaid taxes or rates for which the *taxable event* has yet to occur

TAX INVOICE Rates & Valuation Notice
2018/2019

Rates and Charges for the 12 month period
1 July 2018 to 30 June 2019

Telephone enquiries to Council's Services Centre 8:30 am – 5:00 pm
Telephone 8290 1333 Monday – Friday

Payment Options
1. Total Amount Payable
\$1,034.55
By 31 March 2019

OR
2. Instalment Amount Payable
\$257.55
By 30 September 2018

Date of Notice/Service 30 July 2018
Property 50000
Ward NORTH

AASB 1058 – Peppercorn Leases

- Where a NFP lessee has a lease that at inception had significantly below-market terms and conditions principally to enable the entity to further its objectives, the NFP entity shall :
 - Measure the right-of-use asset at fair value
 - Measure the lease liability at the present value of lease payments not paid at that date
 - Recognise any related items in accordance with AASB 1058 (i.e. the difference)

AASB 1058 – Peppercorn Leases

Example:

- An entity built on land leased to it for \$10pa for 99 years
- Present value of remaining lease payments is \$100
- Fair value of the right of use land is \$2m
- The entity had not previously recognised the right-of-use asset for land or a lease liability.

AASB 1058 – Peppercorn Leases

Example:

- The entity is reporting for the period ending 30 June 2020.

Treatment on transition:

<i>Journal entry 1 July 2019</i>	Debit	Credit
Right-of-use asset - land	2,000,000	
Lease Liability		100
Opening retained earnings		1,999,900

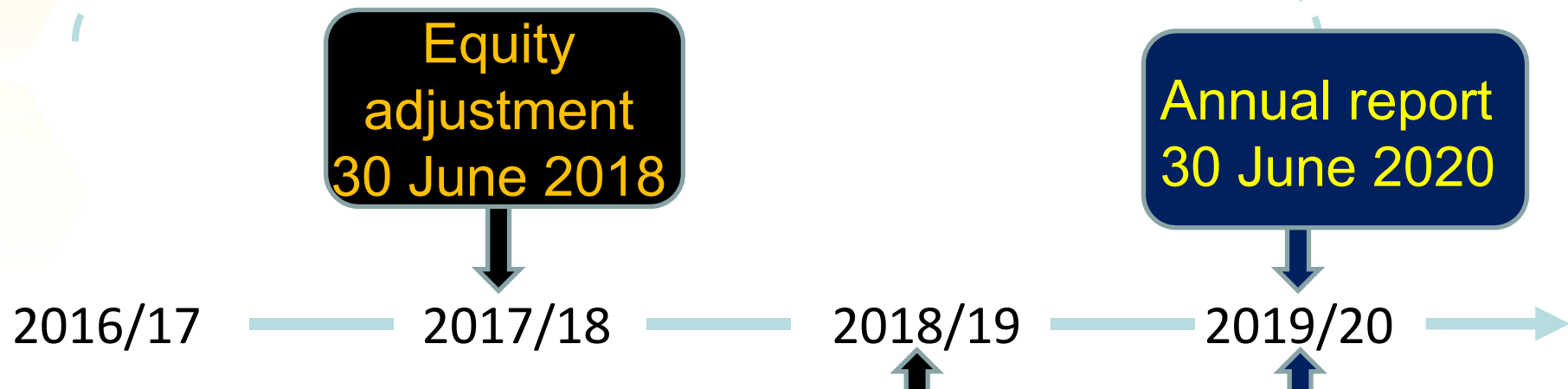
AASB 1058 – Volunteer Services

- Local governments, government departments, general government sectors and whole of governments must recognise an inflow of resources where:
 - they would have been purchased if they had not been donated; and
 - the fair value of those services can be measured reliably.
- Any other NFP can elect
- Disclosure of additional qualitative information is encouraged



Full retrospective vs partial retrospective timeline

Retrospective approach



**Not-for-Profit
AASB 15/1058**

**Equity
adjustment
30 June 2019**

**Annual report
30 June 2020**

Partial retrospective

Full retrospective vs partial retrospective timeline

Retrospective approach

Equity
adjustment
30 June 2017

Annual report
30 June 2020

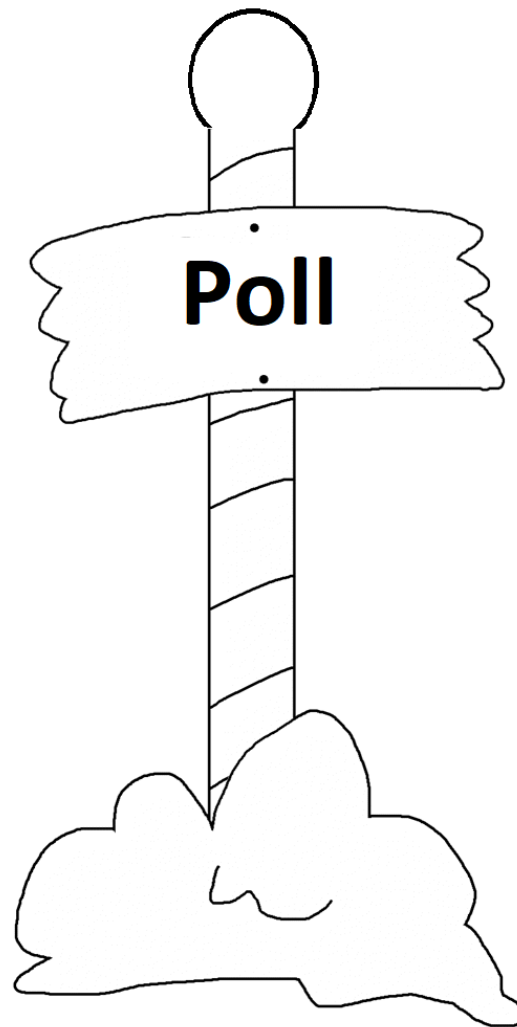
2016/17 — 2017/18 — 2018/19 — 2019/20 —

**For-Profit
AASB 15**

Equity
adjustment
30 June 2018

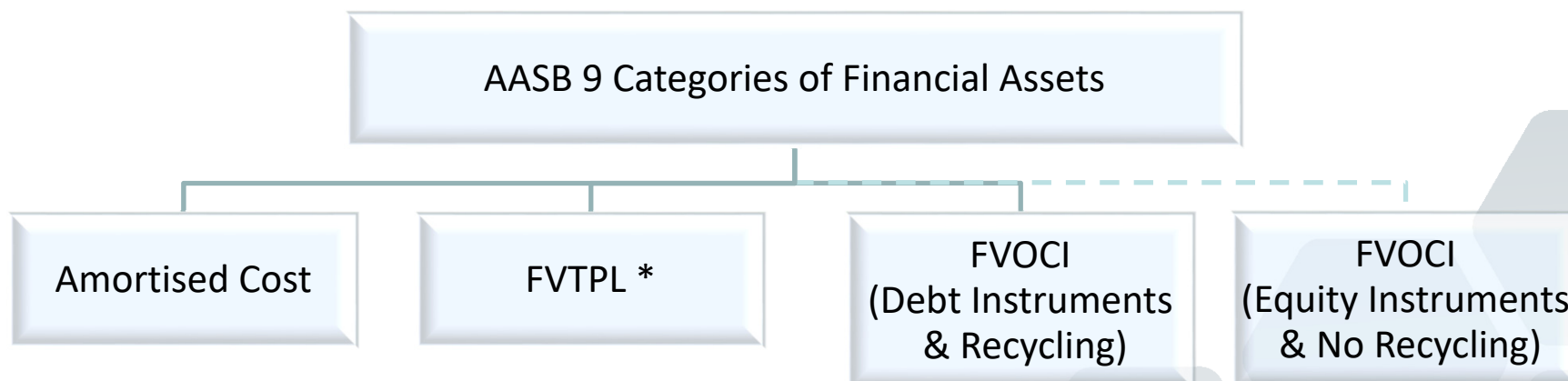
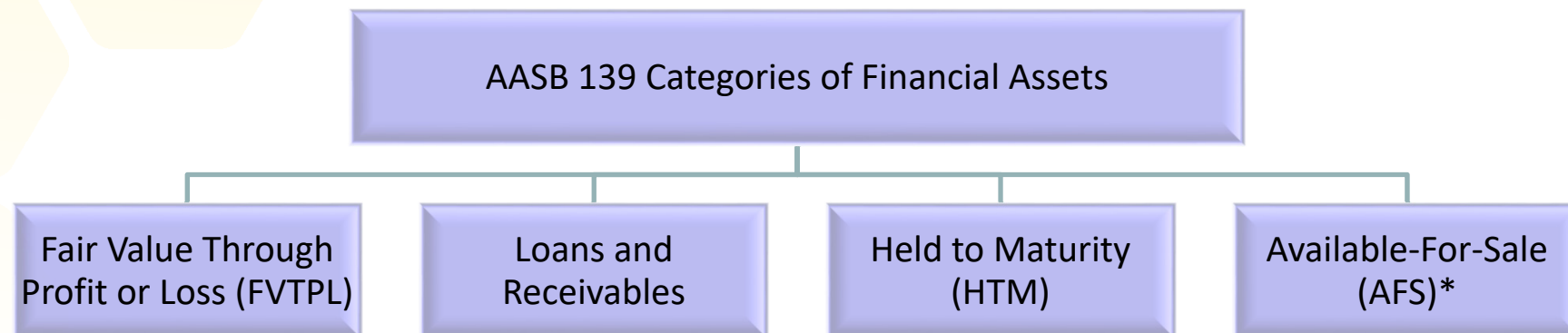
Annual report
30 June 2019

Partial retrospective



AASB 9: *Financial Instruments*

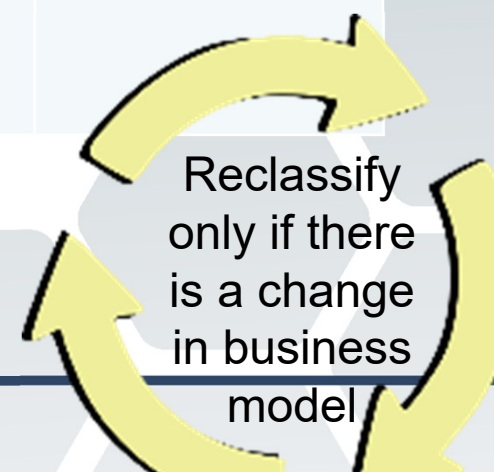
- Categories of Financial Assets



Types of Asset Business Models

An entity's business model is determined at a level that reflects how groups of financial assets are managed together to achieve a particular business objective.

Business Models	Key features	Measure at
Held-to-collect	<ul style="list-style-type: none">Entity holds assets to collect contractual cash flowsSales are incidental to the objective (e.g. Trade Receivables, loans..)	Amortised cost
Held both to collect and for sale	<ul style="list-style-type: none">Both collecting contractual cash flows and sales are integral to achieving the objective of the business model (e.g. Debt instruments)	FVOCI
Others	<ul style="list-style-type: none">Assets are neither held-to-collect nor held to collect and for sale (e.g. Shares held for trading)	FVTPL



AASB 9 – Simplified Impairment



Example provision matrix:

	Current	1–30 days past due	31–60 days past due	61–90 days past due	More than 90 days past due
Historic default rate	0.2%	1.3%	3.0%	5.7%	9.6%
Forward-looking estimate	0.1%	0.3%	0.6%	0.9%	1.0%
Total default rate	0.3%	1.6%	3.6%	6.6%	10.6%

Historical &
Forward -
looking

	Trade receivables A	Expected credit loss B	Impairment allowance AxB
Current	15,000	0.3%	45
1–30 days past due	7,500	1.6%	120
31–60 days past due	4,000	3.6%	144
61–90 days past due	2,500	6.6%	165
More than 90 days past due	1,000	10.6%	106
	30,000		580

AASB 9 – Financial Liabilities

- All financial liabilities to be measured at amortised cost using the effective interest method

except for:

- Financial liabilities at fair value through profit or loss
 - Held for trading
 - designated

AASB 9 – Transition

- Applies on or after 1 January 2018 (i.e. 30 June 2019)
- Full retrospective classification – restatement of comparative periods
 - Not applied to items already de-recognised at the date of initial application
 - Must reclassify all financial instruments (retrospective)
 - Must revoke previous designations that don't meet designation provisions for AASB 9
 - May designate if meet provisions of AASB 9
- Pragmatic - comparatives not required to be restated (reconciliation required)

- the title, nature of change and application date
- the date the entity plans to apply the Standard
- a discussion of the impact; or
- if impact is not known or reasonably estimable, a statement to that effect.

(AASB 10)

Be wary of disclosures that:

Do you have sufficient appropriate audit evidence to support such a statement?



Are you sure?

A close-up of Mr. Bean from the British sitcom 'Mr. Bean'. He has a skeptical, questioning expression on his face, with his eyebrows furrowed and his mouth slightly open. He is wearing his signature green tweed jacket over a white shirt and a red tie. The background is a solid light blue.

Revised Conceptual Framework

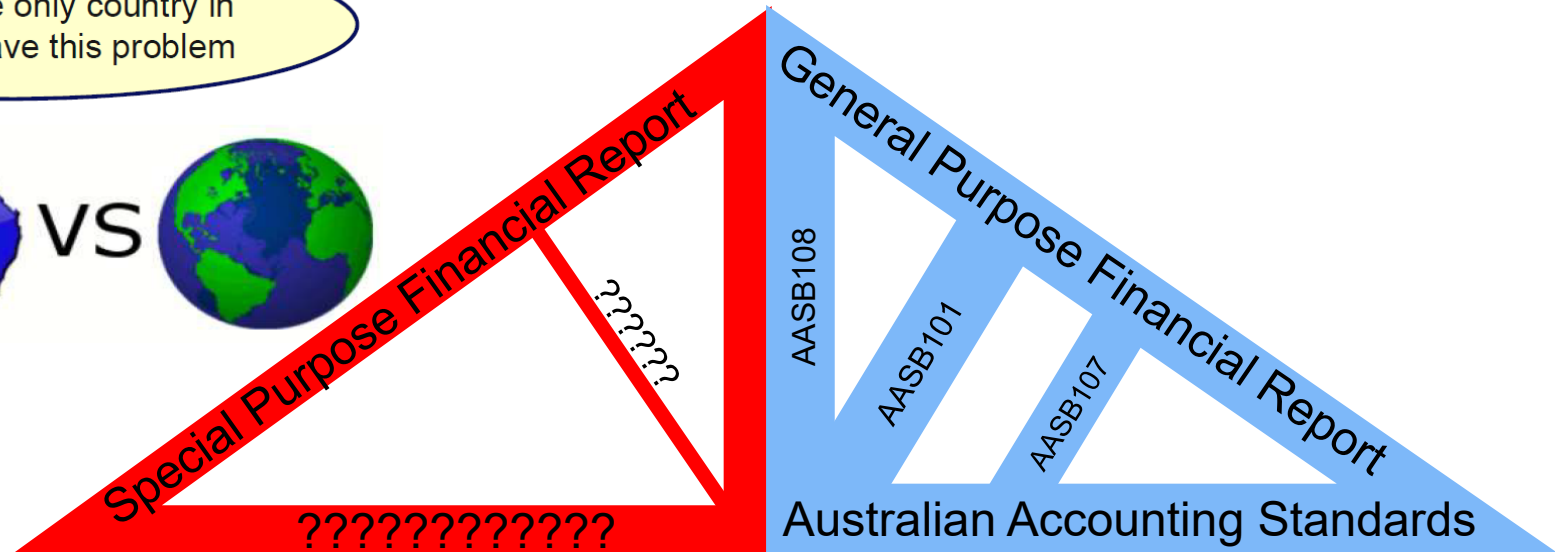


- March 2018 - IASB issued its Revised Conceptual Framework – applies reporting periods on or after 1 January 2020
- Two Problems
 - “Reporting Entity” concept clash
 - Special Purpose Financial Statement problem



Framework

Australia is the only country in the world to have this problem



Non-reporting entity?



Reporting entity

The AASB's preferred solution



Two-phased approach



Phase 1: Short-term approach

- Publicly accountable for-profit entities and other entities who voluntarily comply with IFRS
- RCF / amendments issued 2018
- Amendments effective 1 Jan 2020

Phase 2: Medium-term approach

- All other entities
- Extensive consultation 2018-2020
- RCF / amendments issued 2020
- Amendments effective TBD (For-profits and Not-for-profits staggered implementation?)



The AASB's preferred solution: Phase 2 (Medium-term approach)



Apply RCF to all entities required by legislation or otherwise to comply with AAS

- ✓ IFRS compliance
- ✓ IFRS as a base

Remove SAC 1 and amend AAS to remove Australian reporting entity concept

- ✓ Resolves reporting entity definition clash
- ✓ Resolves self-assessment issue

Alternative 1: Retain existing Tier 2 GPFS – RDR framework; **OR**

Alternative 2: Adopt a new Tier 2 GPFS – SDR framework

- ✓ Resolves SPFS problem
- ✓ Improves trust and transparency

Allows time for extensive consultation, research and transitional support





QUESTIONS



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Client Information Session
Accounting standards update

Thank You