

# Guidance on transition to new Accounting Standards

2018-19



Local Government Victoria



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# Introduction

Local government in Victoria manages approximately \$101.2 billion<sup>1</sup> of community assets and infrastructure and spends around \$8.5 billion<sup>2</sup> on the provision of services annually. Local government, in partnership with other levels of government, is responsible for aspects of everyday life that people care about deeply – from vibrant and safe public spaces, to accessible libraries, to strong local business and employment opportunities. Effective planning and reporting by councils is essential for ensuring transparency and accountability to the community and other levels of government as to how public money is being spent and the quality of services delivered.

## The Local Government Act 1989

The *Local Government Act 1989* (the Act) states the primary objective of a council is to endeavour to achieve the best outcomes for the local community having regard to the long-term and cumulative effects of decisions.<sup>3</sup> The Act sets out local government in Victoria:

- is a distinct and essential tier of government<sup>4</sup>, and
- must provide governance and leadership for the local community through advocacy, decision making and action.<sup>5</sup>

The Act also states it is essential there is a legislative framework that provides for councils to be accountable to their local communities in the performance of functions and the exercise of powers and the use of resources.<sup>6</sup>

It is a statutory requirement under the Act that councils prepare and report on medium and short-term plans to discharge their duties of accountability and transparency to their communities.

## About this guide

Councils are required to prepare an annual report in respect of each financial year including audited financial statements prepared in accordance with the Australian Accounting Standards (AAS).<sup>7</sup> Recent changes to the accounting requirements in the AAS will impact the financial statements prepared by councils in future reporting periods. This guide has been developed to help Victorian councils prepare for and apply the AAS changes to their financial statements.

The guide is not a comprehensive illustration of the requirements of the revised standards, rather it has been prepared to highlight the required actions on transition to the revised standards as well as detail the LGV position in relation to those areas within the standard that provide options in application.

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<sup>1</sup> Victorian Auditor-General's Office (2018), Results of 2017-18 Audits: Local Government

<sup>2</sup> Victorian Auditor-General's Office (2018), Results of 2017-18 Audits: Local Government

<sup>3</sup> Section 3C(1) of the *Local Government Act 1989*

<sup>4</sup> Section 1(1) of the *Local Government Act 1989*

<sup>5</sup> Section 1(4) of the *Local Government Act 1989*

<sup>6</sup> Section 1(5) of the *Local Government Act 1989*

<sup>7</sup> Section 131 of the *Local Government Act 1989*

This guide is presented in three sections.

- **Financial reporting (overview)** provides an overview of the revised AAS and information on the structure of the remainder of the guide.
- **Revised Accounting Standards (summary and options)** provides details of when each revised standard becomes applicable along with a summary of the key changes and likely impact on councils. Also sets out the approach expected to be adopted by the sector where the revised AAS provide options. Includes the position of LGV, the rationale for this position and linkages to any worked examples.
- **Appendices** provides worked examples to show how the changes practically apply to Victorian councils.

The guide is intended for use by local government finance professionals. Each council retains the responsibility for preparing its annual financial statements, including the format and the disclosures made. The guide represents the expected approach to the application of the revised AAS required by LGV and has been developed in close collaboration with the sector and the accounting profession. The guide directs users to related information and further guidance, including Australian Accounting Standards (AAS). Footnotes are used to reference legislative provisions and other relevant information.

### **Impact of revised standards on the 2019-20 budget process**

The 2019-20 model budget has been prepared applying the accounting standards that are in place at the time of preparation of the model. This means that councils are not required to amend the 2019-20 budget for the impact of pending accounting standards that are not yet applicable.

### **Important next steps for councils**

A number of matters should be addressed prior to 1 July 2019 to ensure that councils are collecting the correct information to enable compliance with the revised accounting standards. While the requirements will vary for each council they are likely to include:

#### *AASB 9 Financial Instruments*

- Determine the historic level of doubtful debts to use as part of the determination of expected credit losses for the 2018-19 financial report.

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

- Determine volunteer services that council would otherwise provide (if not provided by volunteers). This would be an internal decision of council, most likely by the director responsible for the delivery of the relevant service.
- Ensure a system to capture the level of volunteer services (hours) provided is in place by 1 July 2019. Note that only volunteer services that would otherwise be provided by council need to be captured. This may involve liaising with other areas of council to develop a volunteer register that meets the required reporting requirements.
- Undertake a high-level review of all revenue streams to determine recognition point under the revised standards.
- Undertake a detailed review of significant contracts (including grants) that are likely to be not complete contracts at 1 July 2019 to determine if any revision to accounting treatment will be required on transition.

#### *AASB 16 Leases*

- Identify all operating leases that relate to assets above the low value threshold and will have more than 12 months duration at 1 July 2019. A reasonable starting point for this process would be the reported lease commitments as at 30 June 2019.

- Establish a process to capture the required asset and liability details at 1 July 2019 and to account for them from that point forward. This may involve the consideration of the acquisition of specialised lease accounting software.
- Ensure that on establishment or renewal of contracts, from 1 July 2019, an appropriate process is in place to identify any potential leased assets.

#### Other matters

- Consider the development of a paper to update your senior management group, audit committee and council on the implications of the revised standards.

## Preparation of this better practice guide

In August 2018 the Local Government Finance Professionals (FinPro) initiated a working group to consider the impacts of the new AAS on Victorian councils. The working group included representatives from the FinPro executive, FinPro volunteer members, the accounting profession and LGV. The purpose of the working group was to drive and inform the development of a proposal for a consistent sector-wide approach to ensure compliance with the new AAS. This guide is the result of the collective efforts of the working group. LGV would like to take this opportunity to acknowledge the contribution of each of the members of the working group towards the development of this guide.

**Table 1: Accounting Standards working group membership**

<b>Core Working Group</b>	
Danny Wain ( <i>Co-Chair</i> )	FinPro Exec and CFO, Monash City Council
Tony Rocca ( <i>Co-Chair</i> )	FinPro Exec and Finance Manager & Governance, Maroondah City Council
Daniel O'Shea	Program Manager Finance and Reporting, Local Government Victoria
Martin Thompson	Partner, Crowe Horwath
<b>FinPro Members</b>	
Ramki Subramaniam	Finance Coordinator, Moira Shire
Libby Erskine	Coordinator Financial Accounting and Services, Port Phillip City Council
Wei Chen	Coordinator Accounting and Reporting, Wyndham City Council
Isabelle Cancino	Acting Finance Manager, Bayside City Council
Sandeep Bordia / Olivia Zhou*	shared role on Working party from Melbourne City Council
Sharon Cole	Financial Accountant, Knox City Council
Wendy McGorm	Coordinator Financial Services , Warrnambool City Council
John Brockway	Finance Manager, Surf Coast Shire
Matthew Jarvis	Manager Finance and Rates, Greater Shepparton City Council
Azam Mahmood	Accountant, Moorabool Shire Council
Justin Marson	Senior Accountant, Ballarat City Council

\*shared role between two council representatives

## Financial reporting (overview)

Revised accounting standards covering revenue, income, leases and financial instruments will impact the financial reporting of Victorian councils in both the 2018-19 and 2019-20 reporting periods. The Australian Accounting Standards Board (AASB) have issued the following new or revised accounting standards relevant to councils:

- *AASB 9 Financial Instruments* (AASB 9)
- *AASB 15 Revenue from Contracts with Customers* (AASB 15)
- *AASB 16 Leases* (AASB 16)
- *AASB 1058 Income of Not-for-Profit Entities* (AASB 1058)
- *AASB 2016-8 Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities*

The most substantial changes expected to impact Victorian councils relate to the recognition of operating leases on the balance sheet (AASB 16) and the timing of revenue recognition in line with performance obligations (AASB 15). Preparing for the revised AAS will require councils to review relevant contracts to determine whether they are (or contain) a lease and to assess and identify any performance obligations. It is recommended that councils commence preparations for these changes as early as possible and seek professional advice if necessary.

Victorian councils must prepare the financial statements in their annual report in accordance with the Local Government Model Financial Report (LGMFR).<sup>8</sup> The 2018-19 and 2019-20 editions of the LGMFR will reflect the relevant disclosures required by the revised AAS to supplement this guide.

The remainder of this guide is structured based on each individual accounting standard and includes information on when the standard first applies, a summary of the key changes and the anticipated impact on councils.

The revised standards include a number of ongoing and transitional options, or practical expedients, that entities can elect to apply. To promote consistency and comparability across the sector this guide sets out LGV's position on these options, including the rationale for the position taken. Victorian councils are expected to adopt these options on transition to the revised standards.

To assist with practically applying the revised accounting standards in a local government context worked examples are available in the Appendices to this guide.

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<sup>8</sup> Regulation 19 of the *Local Government (Planning and Reporting) Regulations 2014*

# Revised Accounting Standards (summary and options)

## AASB 9 Financial Instruments

### When does it apply?

*AASB 9 Financial Instruments* applies to annual reporting periods beginning on or after 1 January 2018, with retrospective application. The first applicable reporting period for Victorian councils will be 2018-19.

### What is changing?

AASB 9 simplifies the model for classifying and recognising financial assets from four categories into three categories – financial assets as subsequently measured at amortised cost, and financial assets measured at fair value through profit or loss or through other comprehensive income. AASB 9 adopts an ‘expected loss model’ for impairment assessment, where the expected losses are recognised throughout the life of a loan or other financial asset measured at amortised cost, and not only after a loss event has been identified. The revised standard no longer requires a credit event (eg. a receivable is past due) to have occurred before recognising credit losses. As a result, impairment losses will be recognised earlier and at more regular intervals than under the existing ‘incurred loss model’ of *AASB 139 Financial Instruments: Recognition and Measurement*.

### How does it impact local government?

The initial application of AASB 9 is not expected to significantly impact the sector’s finances. While there are a number of changes to the treatment and recognition of financial instruments under the new standard, the only likely impact on the sector is the need to move to an expected credit loss model for the calculation of provisions for doubtful debts. Under this approach, councils will be required to consider past performance as well as current information in determining an appropriate provision for doubtful debts.

Key to the new requirements is that councils no longer need to wait for a credit event to occur prior to recognising a provision for doubtful debt. This will result in provisions being recognised earlier than under the previous model. While the overall impact of the new requirements will be negligible, by bringing the point of recognition forward a potential exists for a one-off impact on the transition to the new standard. While it is not expected that this impact will be material, councils can determine the impact by calculating the provision based on both the new (ECL) and former methods. If significant the impact can be disclosed by way of inclusion of a narrative in the relevant note (provision for doubtful debts) to the financial statements. The 2018-19 edition of the LGMFR will be updated to reflect the requirements of AASB 9.



The table below details LGV's position on the options or practical expedients available on transition (or ongoing) in AASB 9. Bold text indicates the option councils are expected to apply.

**Table 2: AASB 9 Financial Instruments**

<i>AASB 9 Financial Instruments options or practical expedients available on transition (or ongoing)</i>				
<b>Paragraph number</b>	<b>AASB 9 Accounting Option</b>	<b>LGV Position</b>	<b>Rationale</b>	<b>Example/Reference</b>
7.2.15	Subject to making certain disclosures the standard allows an entity not to restate prior period information for classification and measurement of financial assets and liabilities on transition to AASB 9.  Alternatively, an entity may restate prior periods if it is possible without the use of hindsight.	<b>Do not restate the prior year for classification and measurement – all changes on adoption of AASB 9 due to classification and measurement are taken to opening retained earnings at 1 July 2018.</b>  <b>Disclosures required by AASB 7 paragraphs 42L – 42O are required.</b>	Consistency with recommendation for AASB 15 and 16.  Impact of AASB 9 not expected to be significant.  Less onerous for Councils – limited benefit of retrospective application but potentially significant costs.	Appendix A – Example 1

Note that the following are not mandated by LGV, as they will depend on the Council's transactions and balances and relate more to judgements rather than accounting policy choices:

- Designation of any investments as fair value through other comprehensive income
- Determining whether financial assets meet the criteria to be held at amortised cost
- Determining whether there has been a significant increase in credit risk for receivables
- Determining impairment in accordance with the expected credit loss model.

## **AASB 15 Revenue from Contracts with Customers**

### **When does it apply?**

*AASB 15 Revenue from Contracts with Customers* applies to annual reporting periods beginning on or after 1 January 2019 for not-for-profit entities. The first applicable reporting period for Victorian councils will be 2019-20.

### **What is changing?**

AASB 15 requires an assessment of enforceability and the determination of performance obligations. The core principle of AASB 15 is to recognise revenue when the entity (council) satisfies a performance obligation by transferring a promised good or service to a customer. The changes in revenue recognition requirements may result in changes to the timing and amount of revenue recognised by Victorian councils.

The 2018-19 edition of the LGMFR will include pending accounting standard disclosures on the impacts of AASB 15. The 2019-20 edition of the LGMFR will be updated to reflect the requirements of AASB 15.

### **How does it impact local government?**

The only impact of the amended standard is on the timing of revenue recognition, the standard does not impact revenue measurement. While it is not expected that the changes will have a significant impact on the local government sector care will need to be taken to consider all revenue streams (from contracts with customers). The key change to the standard is the move from a focus on control of the underlying asset to the delivery of performance obligations. As such potential changes may occur when council gains control of an asset prior to the delivery (by council) of the related performance obligation. Under the current framework the default position is to recognise revenue when a council gains control of the underlying asset (such as a grant, lease rental or membership fee). Under the new framework a council will need to carefully consider the underlying agreement (contract with customer) to determine if the council is required to meet a sufficiently specific performance obligation, if they do, then the recognition of revenue will need to be deferred until the performance obligation has been met.

Developer Contributions Plans (DCP's) – given the varying and complex nature of DCP's this guidance does not specifically deal with these arrangements. However, the principles of revenue recognition (including identifying a council's performance obligations under a DCP) will apply to such agreements, requiring relevant councils to determine the appropriate accounting treatment..

The table below details LGV's position on the options or practical expedients available on transition (or ongoing) in AASB 15. Bold text indicates the option councils are expected to apply.

**Table 3: AASB 15 Revenue from Contracts with Customers**

<i>AASB 15 Revenue from Contracts with Customers options or practical expedients available on transition (or ongoing)</i>				
<b>Paragraph number</b>	<b>AASB 15 Accounting Option</b>	<b>LGV Position</b>	<b>Rationale</b>	<b>Example/Reference</b>
<b>Transition options</b>				
C3	<p>We note that the same method must be chosen for AASB 15 and AASB 1058.</p> <p><b>Modified (cumulative catch up) adoption – current year (30 June 2020) prepared under AASB 15 and prior year (30 June 2019) prepared under existing standards. Adjustments on adoption taken to retained earnings at 1 July 2019.</b></p> <p>Note – under the modified approach, Councils would be required to report numbers under the existing standards for 30 June 2020 by way of a note disclosure to allow comparability under existing standards.</p> <p>Full retrospective adoption – both current year (30 June 2020) and comparative year (30 June 2019) are prepared under AASB 15. Adjustments on adoption taken to retained earnings at 1 July 2018.</p>	<b>Adopt AASB 15 using the modified (cumulative catch up) approach.</b>	<p>Option allowed in AASB 15 to make transition to the standard easier by adopting modified (cumulative catch up) approach.</p> <p>Additionally, the adopted method will be less costly to implement than full retrospective adoption.</p> <p>Disclosure of impact will be mandated in the 2019-20 Local Government Model Financial Report (LGMFR).</p>	<p>Appendix B – Example 2</p> <p>Appendix B – Example 3</p>
C7	<p>Practical expedients</p> <p>Under the modified (cumulative catch up) method, entities may elect to apply AASB 15 only to contracts that are not complete contracts at the date of initial application (1 July 2019).</p> <p>Not complete contracts are those:</p> <ul style="list-style-type: none"> <li>• where all goods / services have not been transferred or</li> <li>• where revenue has not previously all been recognised</li> </ul>	<b>Mandate councils to use this practical expedient.</b>	<p>Adopting this approach will limit the implementation considerations to only those contracts that are not complete at 1 July 2019.</p>	<p>Where a customer has paid in advance of the receipt of service, a contract is not complete until the council has provided the required services. Examples include:</p> <ul style="list-style-type: none"> <li>• gym memberships</li> <li>• prepaid transfer station vouchers</li> <li>• venue hire charges</li> </ul>
<b>Ongoing options</b>				

**AASB 15 Revenue from Contracts with Customers options or practical expedients available on transition (or ongoing)**

Paragraph number	AASB 15 Accounting Option	LGV Position	Rationale	Example/Reference
4	Entity can choose to apply AASB 15 to a portfolio of contracts (or performance obligations) with similar characteristics if the entity reasonably expects that the effects on the financial statements would not differ materially from applying this Standard to the individual contracts (or performance obligations) within that portfolio. When accounting for a portfolio, an entity shall use estimates and assumptions that reflect the size and composition of the portfolio.	<b>Allow, but not mandate councils to use this expedient.</b>	A portfolio basis can only be used if it is not materially different from applying the standard to individual contracts and therefore councils can choose whichever approach is more practical for them.	A portfolio approach could be applied to a group of like contracts, such as gym memberships.
63	An entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.	<b>Mandate the use of this practical expedient.</b>	No benefit for councils to calculate significant financing component for less than one year.	Paragraphs 60-62 of AASB 15 require councils to recognise the existence of significant financing components in a contract, such as when the sale of land involves a deferred settlement. Paragraph 63 allows a council to ignore this requirement where the contract period is less than 12 months.
94	As a practical expedient, an entity may recognise the incremental costs of obtaining a contract as an expense when incurred if the amortisation period of the asset that the entity otherwise would have recognised is one year or less.	<b>Mandate the use of this practical expedient.</b>	No benefit for councils to capitalise costs where the contract length is less than 12 months.	Legal fees incurred in negotiating a contract for the outsourcing of a council aquatic facility (where council is to be paid a fee from the service provider) are an example of incremental costs incurred in obtaining a contract.

**AASB 15 Revenue from Contracts with Customers options or practical expedients available on transition (or ongoing)**

Paragraph number	AASB 15 Accounting Option	LGV Position	Rationale	Example/Reference
120	<p>Paragraph 120 states:</p> <p>An entity shall disclose the following information about its remaining performance obligations:</p> <p>(a) the aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied (or partially unsatisfied) as of the end of the reporting period; and</p> <p>(b) an explanation of when the entity expects to recognise as revenue the amount disclosed in accordance with paragraph 120(a), which the entity shall disclose in either of the following ways:</p> <p style="padding-left: 40px;">(i) on a quantitative basis using the time bands that would be most appropriate for the duration of the remaining performance obligations; or</p> <p style="padding-left: 40px;">(ii) by using qualitative information.</p>		<p>The details of paragraph 120 from <i>AASB 15 Revenue from contracts with customers</i> are included here as they are referenced in paragraph 121 below.</p>	
121	<p>As a practical expedient, an entity need not disclose the information in paragraph 120 for a performance obligation if either of the following conditions is met:</p> <p>a. the performance obligation is part of a contract that has an original expected duration of one year or less; or</p> <p>b. the entity recognises revenue from the satisfaction of the performance obligation in accordance with paragraph B16</p>	<p><b>Mandate the use of this practical expedient.</b></p> <p>The 2019-20 LGMFR will include the full disclosure with guidance provided in the associated LGMFR Better Practice Guide.</p>	<p>Little benefit for councils to conduct the work required to disclose the information in paragraph 120 of <i>AASB 15 Revenue from contracts with customers</i> and unlikely to be material.</p>	<p>Not applicable.</p>

**AASB 15 Revenue from Contracts with Customers options or practical expedients available on transition (or ongoing)**

Paragraph number	AASB 15 Accounting Option	LGV Position	Rationale	Example/Reference
B16	As a practical expedient, when measuring revenue using an output method, if an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date (for example, a service contract in which an entity bills a fixed amount for each hour of service provided), the entity may recognise revenue in the amount to which the entity has a right to invoice	<b>Not mandate but allow the option to use this practical expedient.</b>	Not considered relevant to councils but allow them to use this if applicable.  This allows councils to simplify revenue recognition in certain situations by recognising as revenue the amount that the council has a right to invoice for services provided.	

Note that the following are not mandated by LGV, as they will depend on the Council's transactions and balances and relate more to judgements rather than accounting policy choices:

- Which standard (AASB 15 or AASB 1058) is relevant for Councils revenue streams
- Whether Council is acting as an agent or principal
- How variable consideration should be calculated and the application of the constraint
- Whether multiple contracts with the same customer (or funding provider) should be aggregated
- What are the performance obligations in a contract
- When are performance obligations satisfied – at a point in time or over time
- Method for measuring progress where performance obligation is satisfied over time
- Allocation of the transaction price to performance obligations
- Whether costs meet the criteria for capitalisation.

## AASB 16 Leases

### When does it apply?

AASB 16 Leases applies to annual reporting periods beginning on or after 1 January 2019. The first applicable reporting period for Victorian councils will be 2019-20.

### What is changing?

AASB 16 replaces the current concept of operating and finance leases (for lessees) and will require lessees to recognise most of their leases on the balance sheet. This key change means most operating leases will be recognised and the financial position of Victorian councils will include more assets and liabilities. Note that AASB 16 retains the concept of operating and finance leases for lessors.

The 2018-19 edition of the LGMFR will include pending accounting standard disclosures on the impacts of AASB 16. The 2019-20 edition of the LGMFR will be updated to reflect the requirements of AASB 16.

### How does it impact local government?

It is important to note that the 'grandfathering' options under the revised standard only apply to those contracts that have not previously been identified as containing a lease. Existing finance and operating leases must be accounted for under the requirements of the revised standard.

Where a council is applying the modified (cumulative catch up) approach to the adoption of this standard, as mandated by this document, the initial impact of the standard for councils will be as follows:

- For operating leases existing on transition (1 July 2019) that have a remaining life greater than 12 months and are for assets above the low value threshold (existing capitalisation threshold for a like asset to a maximum of \$10,000). These leases will need to be recognised on the balance sheet as right of use assets and lease liabilities. The initial recognition will be at the NPV of the future lease payments.
- Finance leases existing on transition will remain on balance sheet with minor disclosure amendments to align with the new standard.
- Any contracts revised, extended or entered into post 1 July 2019 will need to be reviewed to determine if they contain a lease. If they do, the underlying asset will need to be recognised on balance sheet as a right of use asset and lease liability based on a reasonable estimate of the NPV of the payments associated with the asset component of the contract.

The table below details LGV's position on the options or practical expedients available on transition (or ongoing) in AASB 16. Bold text indicates the option councils are expected to apply.

Table 4: AASB 16 Leases

<b>AASB 16 Leases options or practical expedients available on transition (or ongoing)</b>				
<b>Paragraph number</b>	<b>AASB 16 Accounting Option</b>	<b>LGV Position</b>	<b>Rationale</b>	<b>Example/Reference</b>
<b>Transition options</b>				
C3	<p>An entity (lessor or lessee) is not required to reassess whether a contract is, or contains, a lease at the date of initial application.</p> <p>The entity is permitted to:</p> <ul style="list-style-type: none"> <li>- Apply AASB 16 to contracts previously identified as leases under AASB 117 <i>Leases / Interpretation 4 Determining whether an Arrangement contains a Lease</i></li> <li>- Not to apply AASB 16 to contracts that were not previously identified as containing a lease applying AASB 117 <i>Leases / Interpretation 4 Determining whether an Arrangement contains a Lease</i>.</li> </ul>	<p><b>Mandate the use of this practical expedient.</b></p> <p>A grandfathering approach is considered practical for agreements that were previously assessed at inception as not containing leases under AASB 117 and associated interpretations.</p> <p>However, we encourage councils to identify contracts which could meet the definition of a lease under AASB 16 since on renewal date of those contracts; they will need to be accounted for under AASB 16.</p>	<p>The cost of applying AASB 16 is significant given the number of leases in place at councils.</p> <p>The preference would be to focus on putting time and effort into ensuring that existing leases are accounted for correctly under AASB 16.</p> <p>Councils must apply AASB 16 to new or varied contracts from 1 July 2019.</p>	<p>Appendix C – Example 5 Appendix C – Example 6 Appendix C – Example 8</p> <p>The new standard will need to be applied to existing operating leases:</p> <ul style="list-style-type: none"> <li>• with a remaining term greater than 12 months, and</li> <li>• for assets that are above the low value threshold</li> </ul>
C5	<p>A lessee shall apply AASB 16 to its leases using either:</p> <p><b>Modified (cumulative catch up) adoption – current year (30 June 2020) prepared under AASB 16 and prior year (30 June 2019) prepared under existing standards. Adjustments on adoption taken to retained earnings at 1 July 2019.</b></p> <p>or</p> <p>Full retrospective adoption – both current year (30 June 2020) and comparative year (30 June 2019) are prepared under AASB 16. Adjustments on adoption taken to retained earnings at 1 July 2018.</p>	<p><b>Mandate modified (cumulative catch up) method of adoption for councils.</b></p>	<p>Consistent with proposed revenue treatment and allows councils to take advantage of a number of practical expedients in AASB 16 which are only available where modified (cumulative catch up method) is used.</p> <p>This allows councils to only account for existing leases prospectively. With any impact being taken to retained earnings at the date of initial application (1 July 2019).</p>	Appendix C – Example 4



**AASB 16 Leases options or practical expedients available on transition (or ongoing)**

Paragraph number	AASB 16 Accounting Option	LGV Position	Rationale	Example/Reference
C8	<p>If a lessee elects to apply this Standard in accordance with paragraph C5(b), the lessee shall:</p> <p><b>(a) recognise a lease liability at the date of initial application for leases previously classified as an operating lease applying AASB 117.</b> The lessee shall measure that lease liability at the present value of the remaining lease payments, discounted using the lessee’s incremental borrowing rate at the date of initial application.</p> <p><b>(b) recognise a right-of-use asset at the date of initial application for leases previously classified as an operating lease applying AASB 117.</b> The lessee shall choose, on a lease-by-lease basis, to measure that right-of-use asset at either:</p> <p>(i) its carrying amount as if the Standard had been applied since the commencement date, but discounted using the lessee’s incremental borrowing rate at the date of initial application; or</p> <p>(ii) an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application</p>		<p>The details of paragraph C8 from <i>AASB 16 Leases</i> are included here as they are relevant to the option in paragraph C8b below.</p>	

**AASB 16 Leases options or practical expedients available on transition (or ongoing)**

Paragraph number	AASB 16 Accounting Option	LGV Position	Rationale	Example/Reference
C8b	<p>Right of use for each lease is measured at either:</p> <ul style="list-style-type: none"> <li>- <b>an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application.</b></li> </ul> <p>or</p> <ul style="list-style-type: none"> <li>- its carrying amount as if AASB 16 had been applied since the commencement of the lease but discounted at the lessee's incremental borrowing rate at the date of initial application.</li> </ul>	<p><b>Mandate the first option for determining right of use asset on initial recognition.</b></p> <p>This means recognise right-of-use at amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application.</p>	<p>This allows for a simplified measurement of the lease asset as being equal to the remaining lease liability at the date of application (1 July 2019).</p> <p>The cost of separately calculating the ROU asset on commencement of the lease for each lease in place at 1 July 2019 will be significant with limited benefit.</p>	<p>Appendix C – Example 4</p> <p>Appendix C – Example 5</p> <p>Appendix C – Example 6</p> <p>Appendix C – Example 7</p> <p>Appendix C – Example 8</p>
C10a	<p>A lessee may apply a single discount rate to a portfolio of leases with reasonably similar characteristics (such as leases with a similar remaining lease term) for a similar class of underlying asset in a similar economic environment</p>	<p><b>Allow councils to use this expedient but not mandate it.</b></p>	<p>Not mandated as councils will be using different discount rates and therefore it is not a consistent issue.</p>	
C10b	<p>A lessee may rely on its assessment of whether leases are onerous applying AASB 137 immediately before the date of initial application as an alternative to performing an impairment review. If a lessee chooses this practical expedient, the lessee shall adjust the right-of-use asset at the date of initial application by the amount of any provision for onerous leases recognised in the statement of financial position immediately before the date of initial application.</p>	<p><b>Mandate the use of this exemption.</b></p>	<p>Councils are not expected to have onerous leases, however for consistency and ease this is mandated as the AASB 137 provision would be a reasonable proxy for the impairment of the right-of-use asset.</p>	

**AASB 16 Leases options or practical expedients available on transition (or ongoing)**

Paragraph number	AASB 16 Accounting Option	LGV Position	Rationale	Example/Reference
C10c	A lessee may elect not to apply the requirements in AASB 16 to leases for which the lease term ends within 12 months of the date of initial application. In this case, a lessee shall:  i. account for those leases in the same way as short-term leases; and  ii. include the cost associated with those leases within the disclosure of short-term lease expense in the annual reporting period that includes the date of initial application.	<b>Mandate the use of this exemption.</b>	Leases expiring within 12 months from 1 July 2019 are not considered likely to be material and therefore the preference would be to focus on the leases which extend beyond 30 June 2020.  Allows councils to ignore any lease that will end during 2019-20.	
C10d	A lessee may exclude initial direct costs from the measurement of the right-of-use asset at the date of initial application.	<b>Do not allow the use of this practical exemption.</b>	Given that the expedient in C8b is recommended to be mandated, this expedient is not relevant and therefore if its use is prohibited then it will avoid confusion.	
C10e	A lessee may use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease.	<b>Mandate the use of this practical expedient.</b>	This expedient will allow councils to apply known factors to the lease accounting rather than trying to determine what the answer would have been at the time of the lease commencement and will provide information that is more meaningful to the users.  Allows council to adjust for any changes that occur during 2019-20, such as the execution of a lease extension option.	

**AASB 16 Leases options or practical expedients available on transition (or ongoing)**

Paragraph number	AASB 16 Accounting Option	LGV Position	Rationale	Example/Reference
C11	For leases which were previously classified as finance leases, the carrying amount of the right of use asset and the lease liability at the date of initial adoption is the carrying amount of the lease asset and lease liability immediately prior to the date of adoption under AASB 117.	<b>Whilst not strictly a choice, included for completeness.</b>	Existing balances for finance lease at 30 June 2019 will be opening balances for AASB 16 at 1 July 2019. These balances will then be subject to AASB 16 on an ongoing basis.	
<b>Ongoing options</b>				
5(a)	A lessee may elect not to apply the requirements of AASB 16 to short-term leases.	<b>Mandate that councils make this election for all short-term leases.</b>	The cost of applying AASB 16 is significant and given the short nature of these leases (less than 12 months) – the cost of the accounting is considered to exceed the benefits.	Exclude any lease that has a term of less than 12 months from the requirements of the standard.
5(b)	A lessee may elect not to apply the requirements of AASB 16 to leases for which the underlying asset is of low value.	<b>Mandate that councils make this election for all leases where the underlying asset is of low value.</b>  LGV will provide guidance on the threshold for low value assets in the LGMFR and associated Better Practice Guide. The threshold would not be expected to exceed existing asset capitalisation thresholds and be no higher than \$10,000.	The cost of applying AASB 16 is significant and given the number of leases in place at councils, the preference would be to focus on putting time and effort into getting the high value asset leases correct and take advantage of the exemption in the standard for the low-value assets.  Note that low-value threshold will be consistent across all councils, as it is not related to materiality.	

**AASB 16 Leases options or practical expedients available on transition (or ongoing)**

Paragraph number	AASB 16 Accounting Option	LGV Position	Rationale	Example/Reference
15	A lessee may elect, by class of underlying asset, not to separate non-lease components from lease components and instead account for each lease component and any associated non-lease component as a single lease component.	<p><b>Mandate that councils make this election for each class of asset.</b></p> <p>We note that where expenses are based on variable charges, such as utilities charges on a building, then this would be accounted for on an as incurred basis and therefore not be included as part of the lease liability.</p>	The cost of separating the lease and non-lease components is considered to exceed the benefit to the users.	This allows for the simplification of accounting where a contract includes a lease and fixed service component, such as cleaning / security services on a building lease.
23-25, Aus25.1	Paragraph 23-25 require the initial recognition of a right of use asset to be measured at cost. Paragraph Aus 25.1 allows that where a council is the lessee and the lease has significantly below-market terms and conditions (i.e Peppercorn or Concessional) the council may elect to measure right-of use assets on a class-by-class basis at initial recognition at fair value in accordance with AASB 13 Fair Value Measurement.	<p><b>Allow a council to adopt this approach but not mandate.</b></p>	<p>Paragraph 23-25 require the initial recognition of a right of use asset at cost, this paragraph allows councils to recognise the right of use asset for a concessional lease at fair value.</p> <p>The AASB has indicated that the valuation of the ROU asset at cost is currently a temporary relief while further research is undertaken in this area. Given this, it is reasonable to allow councils to elect the approach that is most suitable to their current circumstance.</p>	If a council elects to measure a right of use asset at cost the initial asset will be the NPV of the future (concessional) lease payments – which in most instances will be insignificant. If a council elects to adopt the option under Aus 25.1 then it will need to determine the fair value of the right of use asset and recognise the difference between the value of the asset and the NPV of the future (concessional) lease payments as a revenue item.

**AASB 16 Leases options or practical expedients available on transition (or ongoing)**

Paragraph number	AASB 16 Accounting Option	LGV Position	Rationale	Example/Reference
29	Subsequent to initial recognition, a lessee shall measure the right-of-use asset applying cost or fair value under AASB 116 or AASB 140.	<b>Mandate that the right-of-use asset is exempt from the fair value requirement and allow councils to carry this asset at cost.</b>	The right-of-use asset is in substance an intangible asset and the revaluation exercise would be costly and comprise of significant estimation. Whilst the tangible assets of councils are required to be held at fair value, there is no reason to apply the same requirement to right-of-use assets. The right of use would be presented as a separate class of asset and therefore it would not affect any other assets.	
47	Lessee shall present in the statement of financial position or in the notes - Right of use assets separately from other assets - Lease liabilities separately from other liabilities.	<b>Present right-of-use assets and lease liabilities as a separate line item on the face of the statement of financial position.</b> The 2019-20 LGMFR will reflect this presentation.	These line items are likely to be material and therefore the information is more meaningful to the users if they are presented separately rather than being lost in the notes to the financial statements.	
50	Lessee should classify cash payments for the interest portion of the lease liability applying the requirements of AASB 107, i.e. as operating, financing or investing.	<b>Continue to mandate interest paid to be shown as financing cash flows (finance costs) consistent with the LGMFR.</b>  Note the IASB has a project to mandate the presentation of interest and if a standard is issued then this may affect the presentation prior to adoption of AASB 16.	Consistency with existing LGMFR presentation.	

Note that the following are not mandated by LGV, as they will depend on the Council's transactions and balances and relate more to judgements rather than accounting policy choices:

- Identifying whether a contract meets the definition of a lease.
- Where it is reasonably certain that an option included in a lease will be exercised.
- Whether a lease modification is a separate lease or a modification to the existing lease
- Whether a lessor classifies a lease as operating or finance.
- Whether a lessor recognises rental income on a straight-line basis or other systematic basis – although likely to recommend straight-line unless evidence of another basis provides information that is more useful to the users.

## **AASB 1058 Income of Not-For-Profit Entities**

### **When does it apply?**

*AASB 1058 Income of Not-for-Profit Entities* applies to annual reporting periods beginning on or after 1 January 2019. The first applicable reporting period for Victorian councils will be 2019-20.

### **What is changing?**

AASB 1058 largely replaces *AASB 1004 Contributions* and establishes principles for transactions where the consideration to acquire an asset is significantly less than fair value to enable not-for-profit entities to further their objectives. Under AASB 1058 revenue from capital grants that are provided under an enforceable agreement that have sufficiently specific obligations will be deferred and recognised as the performance obligations are satisfied.

The 2018-19 edition of the LGMFR will include pending accounting standard disclosures on the impacts of AASB 1058. The 2019-20 edition of the LGMFR will be updated to reflect the requirements of AASB 1058.

### **How does it impact local government?**

Similar to AASB 15, this standard has the potential to impact the timing of the recognition of contribution revenue by councils. The standard is designed to assist councils in determining how to account for contributions received that are not in the form of revenue from contracts with customers. When a council receives a contribution (asset) the initial accounting for the asset is a simple debit to the balance sheet. AASB 1058 provides direction on how to account for the other side of this entry. The three options available under the standard are to create a liability, equity or revenue. For councils the options are likely to be limited to revenue or liability. In most instances the decision making will be similar to that applied to AASB 15, that is an assessment will need to be made to determine if a council has an unmet performance obligation at the time of gaining control of the contribution, if they do then a liability will need to be recognised until the obligation is met by Council.

The table below details LGV's position on the options or practical expedients available on transition (or ongoing) in AASB 1058. Bold text indicates the option councils are expected to apply.



**Table 5: AASB 1058 Income of Not-for-Profit entities**

<b>AASB 1058 Income of Not-for-Profit entities options or practical expedients available on transition (or ongoing)</b>				
<b>Paragraph number</b>	<b>AASB 1058 Accounting Option</b>	<b>LGV Position</b>	<b>Rationale</b>	<b>Example/Reference</b>
<b>Transition options</b>				
C3	<p>We note that the same method must be chosen for AASB 15 and AASB 1058.</p> <p>Refer to table 3, item C3 above for details on the two available options of either full retrospective adoption or the <b>modified (cumulative catch up) approach</b>.</p>	<p><b>Adopt AASB 1058 using the modified (cumulative catch up) approach.</b></p>	<p>Option allowed in AASB 1058 to make transition to the standard easier by adopting modified (cumulative catch up) approach.</p> <p>Additionally, the adopted method will be less costly to implement than full retrospective adoption.</p> <p>Disclosure of impact will be mandated in the 2019-20 Local Government Model Financial Report (LGMFR).</p>	<p>Refer to transition option C3 for AASB 15 (above).</p>
C6	<p><b>Practical expedients</b></p> <p>Under the modified (cumulative catch up) method, entities may elect to apply AASB 1058 only to contracts that are not complete contracts at the date of initial application (1 July 2019).</p> <p>For this standard, not complete contracts are those where all income has not previously been recognised.</p> <p><b>It is important to note that the definition of not completed contracts differs under AASB 15.</b></p>	<p><b>Mandate councils to use this practical expedient.</b></p>	<p>Adopting this approach will limit the implementation considerations to only those contracts that are not complete at 1 July 2019.</p>	<p>If all funding under a grant was fully recognised by 30 June 2019, that's a complete contract. The practical expedient permits councils to only apply the new standard to contracts where they have not recognised all income at transition date.</p>

**AASB 1058 Income of Not-for-Profit entities options or practical expedients available on transition (or ongoing)**

Paragraph number	AASB 1058 Accounting Option	LGV Position	Rationale	Example/Reference
C8	Councils may have acquired an asset at significantly less than fair value but at a value greater than nil or nominal consideration in prior years and recorded the asset at its cost. Option not to restate the value on transition.	<b>Mandate the use of this practical expedient where the asset is recorded in the statement of financial position at its cost.</b>	It is highly unlikely that councils will be carrying assets that have been acquired for a cost greater than nominal consideration but significantly lower than fair value, as such this practical expedient is unlikely to be applicable.	Not applicable.
<b>Ongoing options</b>				
18	Local governments, government departments, general government sectors (GGSs) and whole of governments shall recognise an inflow of resources in the form of volunteer services as an asset (or an expense, when the definition of an asset is not met) if: (a) the fair value of those services can be measured reliably; and (b) the services would have been purchased if they had not been donated		The details of paragraph 18 from <i>AASB 1058 Income of Not-for-profit entities</i> are included here as they are referenced in paragraph 19 below.	
19	Recognise volunteer services if the fair value can be measured reliably but the services would not have been purchased if they weren't donated.	<b>Prohibit the recognition of volunteer services unless they meet the mandatory recognition criteria in paragraph 18.</b> If councils wish to acknowledge the contribution of their volunteers (to the extent they fail the recognition criteria in the standard) then we encourage councils to include this information in the unaudited section of the annual report rather than in the financial statements.	The valuation of volunteer services is a judgemental process and results in recognition of income and expenses with a nil net result in the income statement. The process for identifying services under paragraph 18 is a management decision.	Appendix D - Example 9

Note that the following are not mandated by LGV, as they will depend on the Council's transactions and balances and relate more to judgements rather than accounting policy choices:

- Which standard (AASB 15 or AASB 1058) is relevant for councils revenue streams.
- Which classes of volunteer services have fair value, which can be measured reliably.
- Whether volunteer services would have been purchased if they had not been donated.





# Appendices

# Appendix A AASB 9 Financial Instruments

## Worked examples

The following worked examples have been developed in conjunction with sector representatives from FinPro. Technical accounting input was provided by Crowe Horwath. The examples aim to present practical, relevant scenarios of how *AASB 9 Financial Instruments* will apply to Victorian councils.

### Example 1 - Calculation of provision for doubtful debts based on expected credit loss (ECL) model

The ECL model requires council to use both forward and backward-looking information to determine the level of provision for impairment of financial assets. In councils this will typically be limited to receivables. The following simplified example explores three scenarios that could occur in council environments. In these examples any known bad debts have been assumed to have been written off.

#### Scenario one

Total receivables:	\$2,500,000
Historic rate of bad debts:	1.5%
Forward looking economic outlook	Neutral

Provision for doubtful debts \$37,500

Provision calculated at 1.5% of total receivables. This is based on past performance and no future (forward looking) information that would impact the calculation.

#### Required Journals (same approach applies to all scenarios)

To create provision based on future expectation:

Dr	Doubtful debts expense (income statement)	\$37,500	
Cr	Provision for doubtful debts (balance sheet)		\$37,500

To write off a bad debt of \$1,000 when identified as not collectable:

Dr	Provision for doubtful debts (balance sheet)	\$1,000	
Cr	Individual account receivable (balance sheet)		\$1,000

#### Scenario two

Total receivables:	\$2,500,000
Historic rate of bad debts:	1.5%
Forward looking economic outlook	Negative

Provision for doubtful debts \$50,000

Provision calculated at 2% of total receivables. This is based on past performance and an adjustment to reflect the projected negative economic outlook on the collectability of receivables.

### Scenario three

Total receivables:	\$2,500,000
Historic rate of bad debts:	1.5%
Forward looking economic outlook	Positive
Provision for doubtful debts	\$25,000

Provision calculated at 1% of total receivables. This is based on past performance and an adjustment to reflect the projected positive economic outlook on the collectability of receivables.

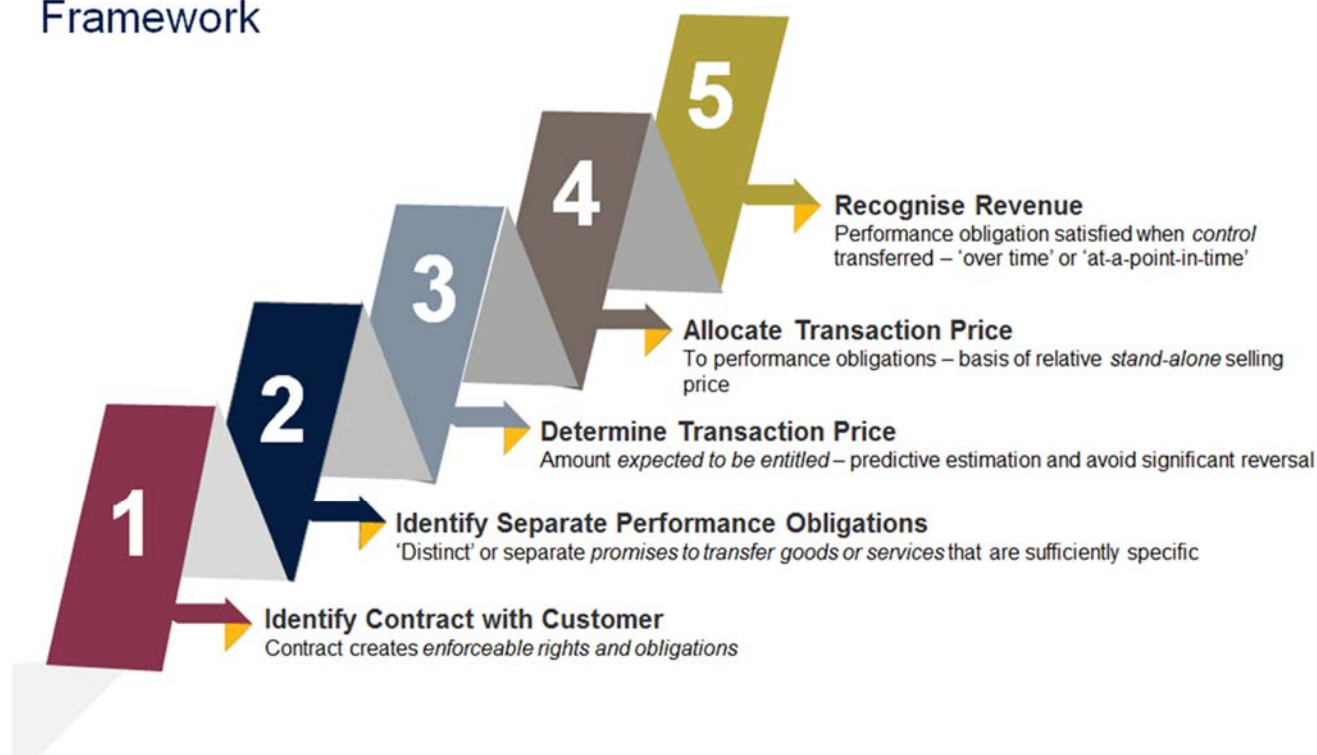
It is important to note that these examples are very simplistic. Individual councils would be expected to have more relevant and targeted forward-looking indicators to provide guidance on expected future losses.

# Appendix B AASB 15 Revenue from Contracts with Customers

## Overview of AASB 15 Framework

The following diagram provides a simple overview of the framework to be applied in determining the point of recognition for revenue in accordance with the requirements of AASB15.

### Framework



## Worked examples

The following worked examples have been developed in conjunction with sector representatives from FinPro. Technical accounting input was provided by Crowe Horwath. The examples aim to present practical, relevant scenarios of how *AASB 15 Revenue from Contracts with Customers* will apply to Victorian councils.

The following examples are illustrative only and each council would need to consider the specifics of their underlying contracts. It is important to reiterate that, in general, the changes to recognition only relate to the timing of revenue recognition and have no impact on the amount of revenue recognised. In many of the examples the proximity of the receipt of fees to the delivery of service (performance obligation) will mean that, in substance no change will be required. In contrast councils will need to carefully consider situations that involve a significant time gap between the delivery of the service (performance obligation) and receipt of related income.



## Example 2 - Revenue from contracts

The number and variety of contracts that a council may enter into with a customer are almost unlimited, however the assessment process under AASB 15 remains constant. The following two examples walk through the assessment process for a typical council's services.

### Aquatic passes

Council provides aquatic passes in books of 10, 20 and 50. These are paid for in advance and can be used up to one year from purchase. The passes cost \$50, \$90 and \$200 respectively. Although no formal contract is entered into the passes are sold with a document detailing key terms and conditions.

### Assessment

Q: Is there a contract with customer

A: Yes, a formal contract is not required to establish contractual obligations. All that is required is the three components of 'offer' (by council) 'acceptance' (by user) and 'consideration' (from user).

Q: Are there identifiable performance obligations

**A: Yes, each access ticket represents an obligation on council to provide access to the aquatic facilities**

Q: Determine transaction price

A: Transaction price can be determined as the total purchase price divided by the number of entries available

Q: Allocate transaction price

A: transaction price is allocated to each ticket

Q: Recognise revenue

**A: Revenue recognised on use of ticket, or (for any unused tickets) at the expiration of 12 months**

### Kindergarten fees

Kindergarten fees, for those not paying by direct debit, are paid for the year in advance (Feb - Nov), with the option for refunds for any full terms that a child does not attend. Parents sign an enrolment form that details all relevant terms and conditions.

### Assessment

Q: Is there a contract with customer

A: Yes, the enrolment will likely establish a contractual relationship

Q: Are there identifiable performance obligations

**A: Yes, council to provide kindergarten facilities and activities as per the terms of the enrolment agreement**

Q: Determine transaction price

A: Transaction price determined as total enrolment fee divided by the number of hours of services provided

Q: Allocate transaction price

A: Transaction price allocated on the basis of hours of service provided

Q: Recognise revenue

**A: Revenue recognised as Council provides services**

## Example 3 - Revenue from grants

(also refer to Appendix D)

Note, Grant revenue could be accounted for under AASB 15, or in certain situations AASB 1058. This will not impact on the timing of the recognition of revenue or income. Regardless of whether applying AASB 15 or AASB 1058 the assessment of grant revenue follows a similar process to that of revenue from contracts with customers detailed in the preceding examples. Grants accounted for under AASB 15 are those where the grant established a performance obligation on the council that approximates the fair value of the consideration (grant) received. The preceding table details a range of grants with some identified as having sufficiently specific performance obligations resulting in the grant income being recognised as the obligations are met, in contrast there are a number of grants without specific performance obligations, that are recognised as revenue upon control of the underlying asset, typically receipt.

### Capital grants

Capital grants are covered under paragraph 15 & 16 of AASB 1058. For most capital grants these paragraphs require the initial recognition of a contribution as a liability, which is then recognised as income as council progressively satisfies the specific performance obligations. An important point is the need to recognise capital grant income as a performance obligation is progressively met. This means that where a council is midway through the construction of a building, and the performance obligation is to construct the building, they would recognise grant income in line with the proportion of the costs incurred to date.

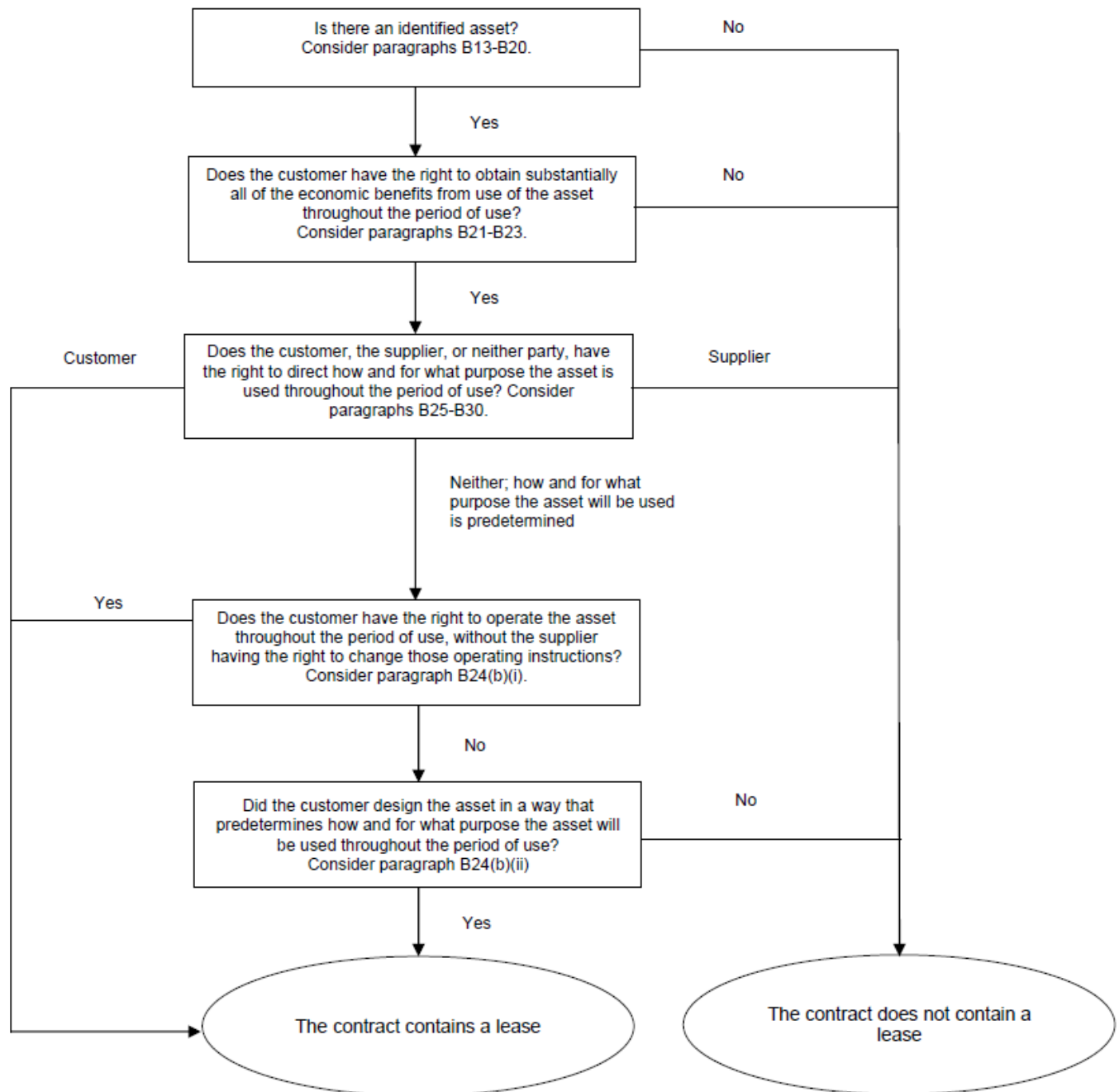
Several potential questions in relation to grant income are as follows:

- Q. Does the payment schedule in a grant agreement align with income recognition?
- A. Not necessarily, progress payments detailed in a grant agreement are not performance obligations, however in many instances they may be closely aligned.
  
- Q. What if we don't get the funding until we complete the capital project (or part thereof)?
- A. If you progressively meet a specific performance obligation of a capital grant agreement prior to receipt of funding it is appropriate to recognise the income (and receivable) at that point.
  
- Q. What if the grant only covers 50% of the project cost?
- A. In the absence of anything to the contrary in the grant agreement, there is no requirement to pro rata recognition of grant income based on the proportion of the grant to the total project.

# Appendix C AASB 16 Leases

## AASB 16 application guidance

The following flowchart is reproduced from *AASB 16 Leases*<sup>9</sup> and may assist entities in making the assessment of whether a contract is, or contains, a lease.



<sup>9</sup> AASB 16 Leases, Appendix B, Australian Accounting Standards Board

## Worked examples

The following worked examples have been developed in conjunction with sector representatives from FinPro. Technical accounting input was provided by Crowe Horwath. The examples aim to present practical, relevant scenarios of how *AASB 16 Leases* will apply to Victorian councils.

### Example 4 – Accounting for a lease on transition to the revised standard

#### Summary of Situation - Transition Lease

Council entered into an operating lease for a building on 1 July 2016  
 Council pays a \$100,000 annual rental (on 30 June)  
 Council cost of finance 4.5%  
 Council has a lease for the period 1 July 2016 - 30 June 2026

#### Assessment

#### Comment

Is there an identified asset	Yes	The building subject to the agreement
Does Council have the right to obtain the benefits from using the asset	Yes	Access to the building
Is the contract greater than 12 months	Yes	10 years
Materiality	Yes	Assumed
<b>Does a lease exist</b>	<b>Yes</b>	

#### Accounting treatment

<b>Initial Entry 1 July 2019 (year 4)</b>		
Dr	Right of use (asset) - non-current	\$589,270
Cr	Lease Liability	\$589,270
	<i>Calculated as the NPV of the remaining lease payments (7 @ \$100,000)</i>	

#### Year 4 (30 June 2020)

Dr	Interest expense	\$26,517	
Dr	lease liability	\$73,483	
Cr	Bank		\$100,000
	<i>To recognise monthly lease payment</i>		
Dr	Depreciation expense	\$84,181	
Cr	Right of use (accum Depn)		\$84,181
	<i>Straight line depreciation of right of use asset</i>		

### Year 5 (30 June 2021)

Dr	Interest expense	\$23,210	
Dr	lease liability	\$76,790	
Cr	Bank		\$100,000
	<i>To recognise monthly lease payment</i>		
Dr	Depreciation expense	\$84,181	
Cr	Right of use (accum Depn)		\$84,181
	<i>Straight line depreciation of right of use asset</i>		

## Example 5 – Commercial lease

### Summary of Situation - Commercial lease

Council has entered into a commercial lease for office accommodation commencing 1 July 2018  
 The area of the lease is clearly defined (floors and carparks) and is for the exclusive use of Council  
 Council pays \$1.2m in annual rent (monthly)  
 The lease term is 5 years with a 5-year option at the lessee's discretion  
 As the interest rate is not explicit in the agreement it is appropriate to use Council's cost of finance (equivalent term) - in this example this is assumed to be 4%.  
 The lease payment will increase by CPI each two years from commencement  
 At the commencement of year 3 the CPI has increased 6% (this will not be known at the start of the lease term)

Assessment		Comment
Is there an identified asset	Yes	The portion of the building subject to the agreement
Does Council have the right to obtain the benefits from using the asset	Yes	
Is the contract greater than 12 months	Yes	5 years
Is Council virtually certain that they will exercise the lease option	No	Given this term is based on 5 years (if Council was virtually certain term would be 10 years).
Materiality	Yes	Assumed
<b>Does a lease exist</b>	<b>Yes</b>	

### Accounting treatment

#### Initial entry

Dr	Right of use (non-current) asset	\$5,429,907		NPV of 60 monthly payments of \$100,000 at an annual finance cost of 4%
Cr	Lease liability		\$5,429,907	
	<i>To account for initial lease entries</i>			

#### Month 1

Dr	Interest expense	\$18,100		
Dr	Lease liability	\$81,900		
Cr	Bank		\$100,000	
	<i>To recognise monthly lease payment</i>			
Dr	Depreciation expense	\$90,498		Straight line depreciation of right of use asset
Cr	Right of use (accum Depn)		\$90,498	

#### Month 2

Dr	Interest expense	\$17,827		Note reduction in interest exp as lease term reduces
Dr	Lease liability	\$82,173		
Cr	Bank		\$100,000	
	<i>To recognise monthly lease payment</i>			
Dr	Depreciation expense	\$90,498		Straight line depreciation of right of use asset
Cr	Right of use (accum Depn)		\$90,498	

*The above entries are continued monthly through to the completion of year 2, which triggers the CPI adjustment*

#### Commencement of year 3 - 6% CPI adjustment

	New monthly payment	\$ 106,000		
	Remeasured liability	\$3,590,301		
Dr	Right of use asset	\$ 203,225		
Cr	Lease liability		\$ 203,225	

### Month 25

Dr	Interest expense	\$ 11,968	
Dr	Lease liability	\$ 94,032	
Cr	Bank		\$106,000
	<i>To recognise monthly lease payment</i>		

Dr	Depreciation expense	\$ 96,144	
Cr	Right of use (accum Depn)		\$ 96,144

*The above entries are continued monthly through to the completion of year 4, which triggers the CPI adjustment*

## Example 6 – Basic fleet lease

### Summary of Situation – Basic fleet lease

Council has entered into a master lease agreement for the lease of various items of plant and equipment. Each item under the master lease agreement is subject to a separate term and payment schedule (lease schedule).

Council controls the assets subject to the lease agreement

Lease terms can be varied from 36 months to 120 months

Assessment		Comment
Is there an identified asset	Yes	Each 'lease schedule' will detail the asset in question
Does Council have the right to obtain the benefits from using the asset	Yes	Council have total control of the asset
Is the contract greater than 12 months	Yes	3 - 10 year terms
Materiality	Yes	Assumed
<b>Does a lease exist</b>	<b>Yes</b>	

### Example of Information in lease schedule

Lease Reference		A unique identifier or account number
Asset details		2018 Volkswagen Crafter Van Rego 123 XYZ
Lease term	60	Months
Lease payment	\$ 1,057	Monthly
Residual (if applicable)	0	If a residual is included it needs to be incorporated into the NPV calculations. This is done by including the residual payment as a final payment in the NPV calculation. A residual payment may also mean depreciation calculations need to be adjusted to reflect the (potential) residual value of the right of use asset (if it transfers)

Note: Lease schedules will often not include the NPV of the asset being leased

The above example excludes operating costs

### Other information required

NPV of asset	\$47,490	This is usually easily obtained from a simple internet search
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### Accounting treatment

#### Initial entry

Dr	Right of use (non-current) asset	\$47,490		Based on NPV of fair value of asset acquired.
Cr	Lease liability		\$47,490	
	<i>To account for initial lease entries</i>			

#### Month 1

Dr	Interest expense	\$ 476		
Dr	Lease liability	\$ 581		
Cr	Bank		\$1,057	
	<i>To recognise monthly lease payment</i>			
Dr	Depreciation expense	\$ 792		Straight line depreciation of right of use asset
Cr	Right of use (accum Depn)		\$ 792	

#### Month 2

Dr	Interest expense	\$ 470		Note reduction in interest expense as lease term reduces
Dr	Lease liability	\$ 587		
Cr	Bank		\$1,057	
	<i>To recognise monthly lease payment</i>			
Dr	Depreciation expense	\$ 792		Straight line depreciation of right of use asset
Cr	Right of use (accum Depn)		\$ 792	

*The above entries are continued monthly through to the completion of the lease term*

## Example 7 – Waste contract

### Summary of Situation – Waste contract

Council has entered into a 15 year contract with Wasteful Industries for the collection of all waste  
 The contract specifies that 15 vehicles are required  
 Vehicles must be covered in council's agreed signage  
 Vehicles may not be used for other services or contracts  
 Vehicles must meet certain minimum specifications  
 The service will be delivered for a fixed monthly cost of \$270,000  
 The contract cost will increase by CPI on the 3rd, 6th, 9th and 12th anniversary of the contract

### Information not in the contract

Cost of finance to council is 4%  
 The type of truck specified in the contract (including compactor) costs approximately \$400,000

Assessment		Comment
Is there an identified asset	Yes	The 15 vehicles
Does Council have the right to obtain the benefits from using the asset	Yes	Can direct and restrict usage of vehicles
Is the contract greater than 12 months	Yes	15 years
Materiality	Yes	Assumed
<b>Does a lease exist</b>	<b>Yes</b>	

The complication in this example is that the lease cost and service cost are not separately identified. As such council is required to reverse engineer the lease cost based on the known parameters which can be completed as follows:

### Known parameters

Lease term	180	months
NPV of leased assets	\$6,000,000	15 vehicles @ \$400,000
Cost of finance	4%	Annual cost to council

Using the excel payment formula (pmt) the above parameters result in the following:

Monthly lease payment	\$44,381
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This allows the total monthly payment to be split as follows:

Service component	\$225,619
Lease component	\$44,381
<b>Total payment</b>	<b>\$270,000</b>

Accounting treatment			
<b>Initial entry</b>			
Dr	Right of use (non-current) asset	\$6,000,000	NPV of 180 monthly payments of \$44,381 at an annual finance cost of 4%
Cr	Lease liability	\$6,000,000	
<i>To account for initial lease entries</i>			

Month 1			
Dr	Interest expense	\$20,000	
Dr	Lease liability	\$24,381	
Cr	Bank		\$44,381
<i>To recognise monthly lease payment</i>			
Dr	Depreciation expense	\$33,333	Straight line depreciation of right of use asset
Cr	Right of use (accum Depn)	\$33,333	

Month 2			
Dr	Interest expense	\$19,919	Note reduction in interest expense as lease term reduces
Dr	Lease liability	\$24,463	
Cr	Bank		\$44,381
<i>To recognise monthly lease payment</i>			
Dr	Depreciation expense	\$33,333	Straight line depreciation of right of use asset
Cr	Right of use (accum Depn)	\$33,333	

*The above entries are continued monthly through to the completion of year 3, which triggers the CPI adjustment*

#### Commencement of year 3 - 9% CPI adjustment

	New monthly payment (lease portion)	\$ 48,376	
	Remeasured liability	\$ 5,525,350	
Dr	Right of use asset	\$ 456,266	
Cr	Lease liability		\$ 456,266

#### Month 37

Dr	Interest expense	\$18,418	
Dr	Lease liability	\$29,958	
Cr	Bank		\$48,376
	<i>To recognise monthly lease payment</i>		
Dr	Depreciation expense	\$36,502	
Cr	Right of use (accum Depn)		\$36,502

*The above entries are continued monthly through to the completion of year 6, which triggers the CPI adjustment*

## Example 8 – Contribution to community facility in return for right of use

### Summary of Situation - up front contribution

Council has entered into a contract with a local school for use of part of the school facilities  
 Council has exclusive right to the use of a set area of the property as well as shared common use areas  
 Council pays a \$1 annual rental  
 Council contributed \$10m to the construction of the facilities in 2017  
 Council has a lease for the period 1 July 2019 - 30 June 2029

Assessment		Comment
Is there an identified asset	Yes	The portion of the building subject to the agreement
Does council have the right to obtain the benefits from using the asset	Yes	Note that the inclusions of shared common use areas does not necessarily impact on the assessment, however if they represented a significant portion of the overall lease area they could impact calculations
Is the contract greater than 12 months	Yes	10 years
Materiality	Yes	Assumed
<b>Does a lease exist</b>	<b>Yes</b>	

### Accounting treatment

Initial entry		
Dr	Right of use (non-current) asset (initial cost)	\$ 10,000,000
Cr	Bank	\$ 10,000,000
<i>To account for initial contribution</i>		

### Year 1 -10 (annual)

Dr	Lease expense	\$ 1,000,001	
Cr	Prepaid lease (asset) - current		\$ 1,000,000
Cr	Bank		\$ 1
<i>To recognise annual lease expense</i>			
Dr	Prepaid lease (asset) - current	\$ 1,000,000	
Cr	Prepaid lease (asset) - non-current		\$ 1,000,000
<i>To reclassify non-current portion to current</i>			

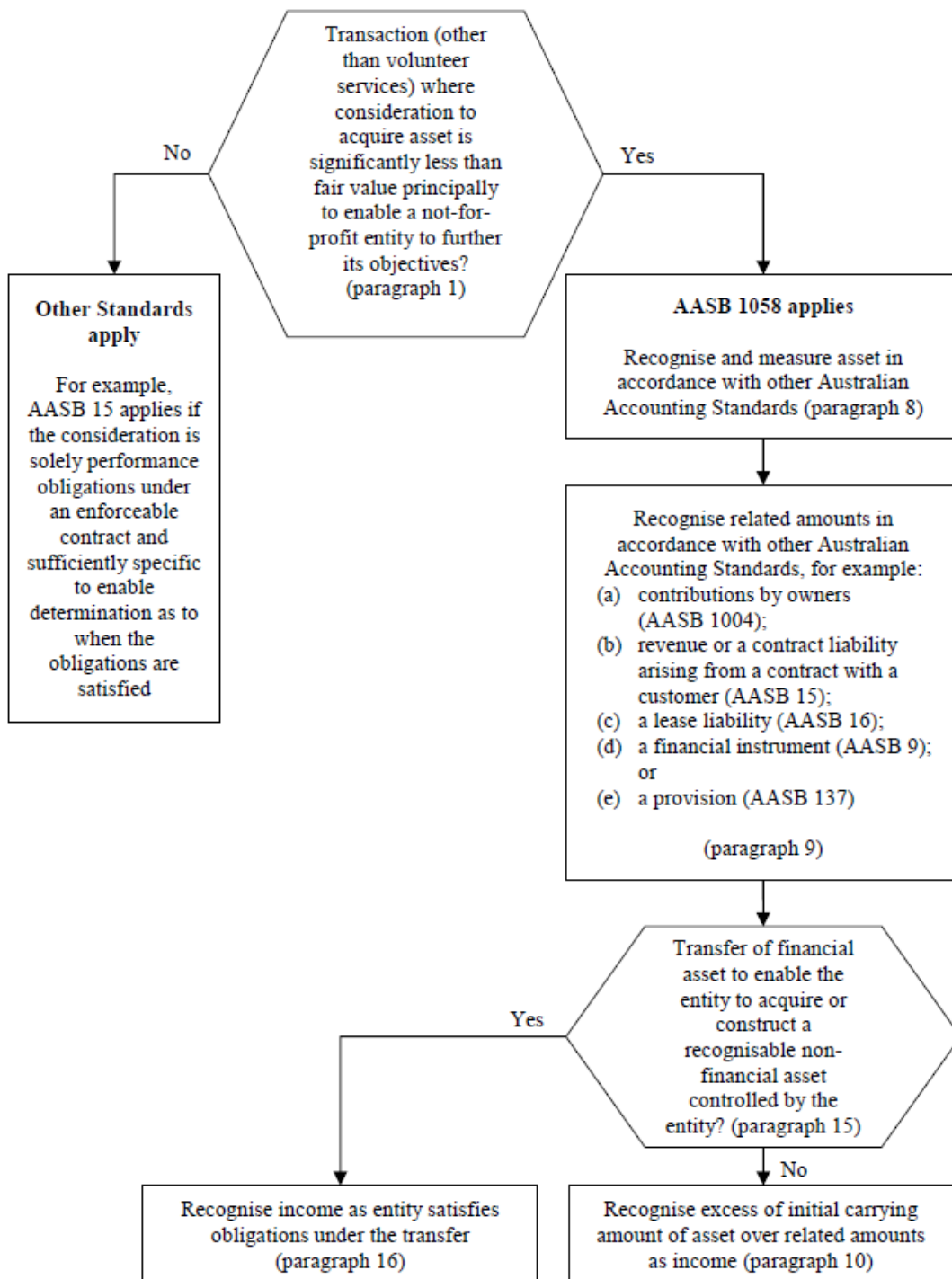
*Note, in practice the above entries would be likely to be processed on a monthly basis*

# Appendix D AASB 1058 Income of Not-for-Profit Entities

## AASB 1058 Application guidance

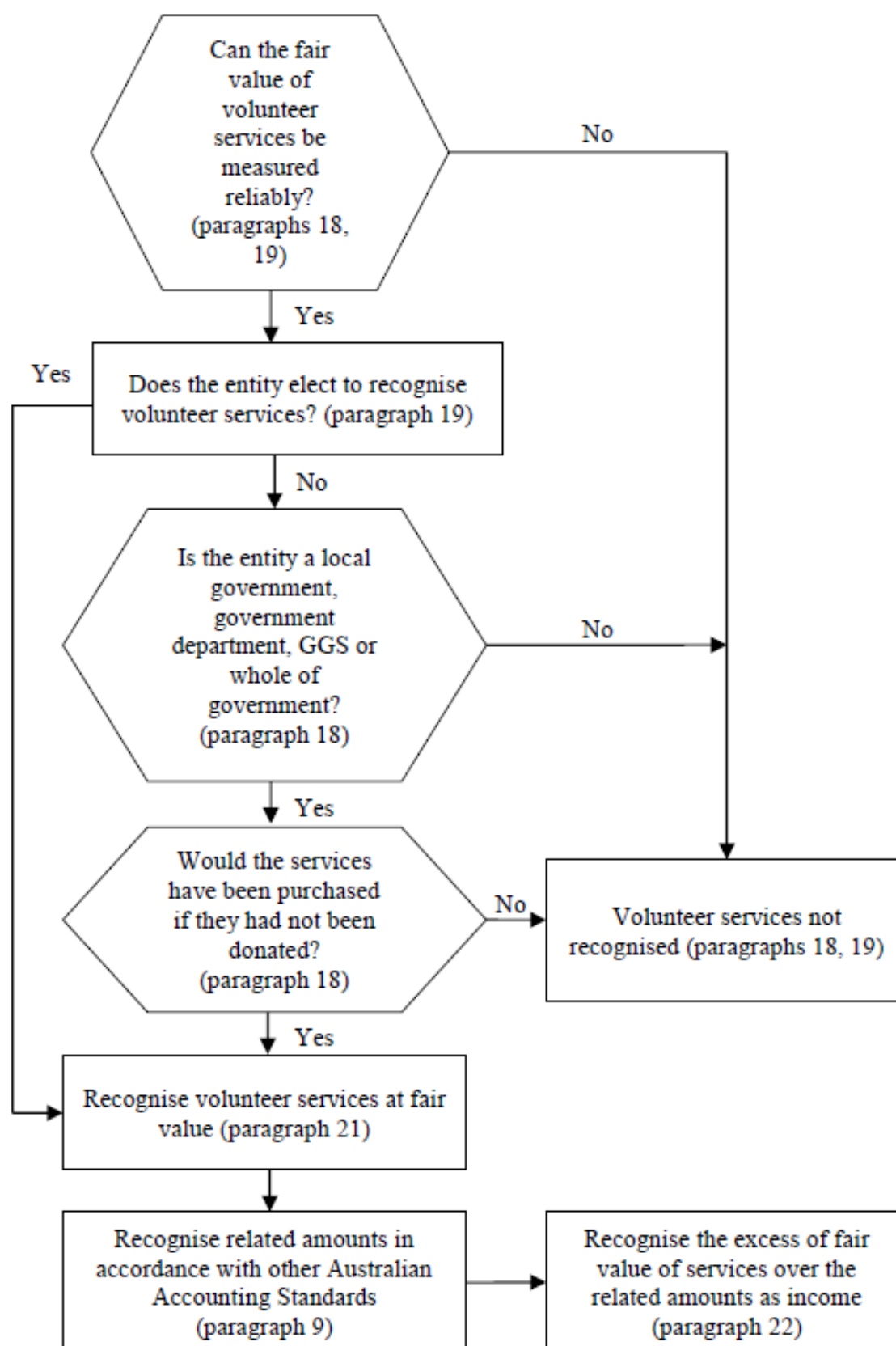
The following flowcharts are reproduced from *AASB 1058 Income of Not-for-Profit Entities*<sup>10</sup> and summarise the main requirements of the standard to assist in its application.

**Chart 1 – Transactions other than Volunteer Services**



<sup>10</sup> AASB 1058 Income of Not-for-Profit Entities, Appendix B, Australian Accounting Standards Board

## Chart 2 – Volunteer Services



## Worked examples

The following worked examples have been developed in conjunction with sector representatives from FinPro. Technical accounting input was provided by Crowe Horwath. The examples aim to present practical, relevant scenarios of how *AASB 1058 Income of Not-for-Profit Entities* will apply to Victorian councils.

### Example 9 – Volunteer services

Council utilises volunteers to provide meal delivery programs to the community. This is a core council service that would be delivered with or without the assistance of volunteers. Further where volunteer numbers have been insufficient in the past council staff have been utilised to deliver meals.

During the year volunteers delivered a total of 15,000 meals, which council estimate would have required 5,000 hours of staff time were they to be delivered by council staff. The base rate for a council employee is calculated at \$31.44.

Based on this the service would represent a service that would otherwise be purchased had it not been provided by volunteers and as such should be recognised as revenue (and a related expense). While the measurement of the revenue is at fair value a reasonable proxy for this, in most instances, would be the minimum hourly rate payable for a similar council service. Note that in calculating the revenue council need to determine both an applicable rate and the hours of services provided. In most instances the hours will align to those provided by volunteer staff, however this is not always a given. For example, it may be significantly more efficient for council staff to deliver the equivalent service to that provided by volunteers. This could be the case when volunteers, delivering meals, also incorporate a level of engagement with clients that a council staff member does not have the capacity to provide. In such instances the revenue would be calculated on the minimum hours required, not necessarily those provided.

Based on the preceding the value of the volunteer services can be calculated as follows:

- |  |           |
|--|-----------|
| • Equivalent hours required for council to deliver services: | 5,000     |
| • Fair value of volunteer services:                          | \$31.44   |
| • Value of volunteer services:                               | \$157,200 |

The relevant accounting entries would be as follows:

- |                                       |           |
|---------------------------------------|-----------|
| • Cr Revenue from Volunteer Services: | \$157,200 |
| • Dr Cost of Service – Meal delivery  | \$157,200 |



## Example 10 - Grants

Grants that fall under AASB 1058 are those where the funding provided is primarily for a council to deliver on its objectives. For example, a council that receives a cash grant to be used to further its objectives might not have provided any consideration in exchange for that cash. This contrasts with a grant where a council enters into an agreement to provide services at or close to the fair value of those services, such as the provision of HACC activities.

In the case of a grant which has been received by a council to further its objectives with no specific obligations, a council will recognise the income on receipt of the grant (or earlier if control can be demonstrated).

While relatively straight forward, a complexity may arise in relation to grants for capital works, which are detailed in the following examples.

### Situation A

Council successfully applies for a \$20m grant to contribute to the development of an art museum  
***The funding agreement simply provides that the funds provided be expended on council capital works. An acquittal may be required at the discretion of the funding agency.***

Council receives the funding on 28 June 2018

The museum project goes ahead with funding expended in 2018-19

The museum is completed and open to the public in August 2019

### Assessment

Q: Is there a contract with customer

A: Yes the funding agreement forms the basis of a contract with customer

Q: Are there identifiable performance obligations

***A: No, while the funding agreement is for capital works it is unlikely that this is specific enough to create a specific performance obligation***

Q: Determine transaction price

A: NA - no specific performance obligation

Q: Allocate transaction price

A: NA - no specific performance obligation

Q: Recognise revenue

***A: Revenue recognised on receipt***

### Situation B

Council successfully applies for a \$20m grant to contribute to the development of an art museum

***The funding agreement requires the funding to be spent on the museum project, if not spent on the museum project funding must be returned***

Council receives the funding on 28 June 2018

The museum project goes ahead with funding expended in 2018-19

The museum is completed and open to the public in August 2019

## Assessment

Q: Is there a contract with customer

A: Yes, the funding agreement forms the basis of a contract with customer

Q: Are there identifiable performance obligations

**A: Yes, the funding must be expended on the construction of a specific building**

Q: Determine transaction price

A: \$20m (the funding amount)

Q: Allocate transaction price

A: As the agreement requires 'funding to be spent on the project' funding will be allocated as expended

Q: Recognise revenue

**A: Revenue recognised as council incurs expenditure.**

## Situation C

Council successfully applies for a \$20m grant to contribute to the development of an art museum

**The funding agreement requires council construct the museum in accordance with the agreed plans and that if the museum is not completed in accordance with the plans, project funding must be returned**

Council receives the funding on 28 June 2018

The museum project goes ahead with funding expended in 2018-19

The museum is completed and open to the public in August 2019

## Assessment

Q: Is there a contract with customer

A: Yes, the funding agreement forms the basis of a contract with customer

Q: Are there identifiable performance obligations

**A: Yes, to qualify for the funding council must complete the construction of the museum.**

Q: Determine transaction price

A: \$20m (the funding amount)

Q: Allocate transaction price

A: Although the agreement requires 'construction to be completed' AASB 1058, paragraph 16 allows for the progressive recognition of revenue received for the construction of an asset

Q: Recognise revenue

**A: Revenue recognised as council incurs expenditure.**

## Example 11 - Income

Councils are entitled to non-contractual receivables arising from statutory requirements such as taxes and rates without providing consideration to the other party – those receivables provide income to the government to further its objectives and are accounted for under AASB 1058.

# Glossary

<b>Act</b>	means the <i>Local Government Act 1989</i>
<b>Annual report</b>	means a report of the council's operations of the previous financial year and contains a report of operations, audited financial statements and an audited performance statement
<b>Australian Accounting Standards (AAS)</b>	means the accounting standards published by the Australian Accounting Standards Board
<b>Better practice</b>	means that in the absence of legislation or a relevant Australian Accounting Standard this commentary is considered by Local Government Victoria to reflect better practice reporting
<b>Budget</b>	means a plan setting out the services and initiatives to be funded for the financial year and how they will contribute to achieving the strategic objectives specified in the council plan
<b>Council plan</b>	means a plan setting out the medium-term strategic objectives, strategies, strategic indicators and resources reflecting vision and aspirations of the community for the next four years
<b>Financial statements</b>	means the financial statements and notes prepared in accordance with the <i>Local Government Model Financial Report</i> , Australian Accounting Standards and other applicable standards as they apply to the general purpose financial reports and statement of capital works, included in the annual report
<b>Financial year</b>	means the period of 12 months ending on 30 June each year
<b>FinPro</b>	means the Local Government Finance Professionals, the peak body servicing Local Government Finance Professionals in Victoria.
<b>Local Government Model Financial Report (LGMFR)</b>	means the Local Government Model Financial Report published by the Department from time to time including on the Department's Internet website.
<b>Local Government Victoria (LGV)</b>	means the division within the Victorian government responsible for administering the <i>Local Government Act 1989</i> .
<b>Minister</b>	means the Minister for Local Government
<b>Principal accounting officer</b>	means the person designated by a council to be responsible for the financial management of the council
<b>Regulations</b>	means the <i>Local Government (Planning and Reporting) Regulations 2014</i>
<b>Report of operations</b>	means a report containing a description of the operations of the council during the financial year and included in the annual report

## References

Australian Accounting Standards Board, AASB Standards,  
<http://www.aasb.gov.au/pronouncements/current-standards.aspx>

Department of Environment, Land, Water & Planning (2018), *Local Government Model Financial Report*, State of Victoria, <https://www.localgovernment.vic.gov.au/strengthening-councils/sector-guidance-planning-and-reporting>

Department of Treasury and Finance (2018), *2018-19 State Budget*, State of Victoria, <https://www.dtf.vic.gov.au/state-budget/2018-19-state-budget>



the 1990s, the number of people in the UK who are employed in the public sector has increased from 10.5 million to 12.5 million. The public sector has become a major employer in the UK, and this has implications for the way in which the public sector is managed and the way in which it is funded.

The public sector is a complex organisation, and it is difficult to understand how it works. This paper aims to provide a simple and clear explanation of the public sector, and to show how it is managed and funded. The paper is divided into three main sections: the public sector, the public sector and the economy, and the public sector and the public.

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