Financial reporting issues and developments

NSW State sector agencies and universities

October 2018

INSIGHTS FOR BETTER GOVERNMENT

FINANCIAL AUDIT

contents

Financial reporting issues and developments

The table below details current issues and financial reporting developments that may impact your entity's financial statements. Management should review these issues and developments, determine those applicable to the entity and assess the impact on the financial statements and annual report. Where this relates to an accounting standard issued but not yet effective, management should disclose the anticipated impact of the standard on their financial statements. Management may consult with their audit team for further information and explanation on the issues and developments detailed below.

NSW state sector agencies should refer to Treasury's latest circular on mandates of accounting policy options and major policy decisions under Australian Accounting Standards when determining whether an accounting standard can be early adopted.

Future reporting developments

Issue 1: AASB 9 'Financial Instruments'

Overview	Applies to
The AASB has released the complete version of AASB 9. This standard replaces the classification, measurement, recognition and de-recognition requirements in AASB 139 'Financial Instruments: Recognition and Measurement'. Key changes include: • reducing financial asset categories from four to three – amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL) • measuring financial assets at fair value unless they are simple debt instruments held for collection of contractual cash flows comprised solely of payments of principal and interest • measuring financial assets at FVOCI if they are held within a business model whose objective is achieved by collecting contractual cash flows and selling financial assets; and the contractual cash flows comprise solely of payments of principal and interest • recognising financial assets at FVTPL unless they are measured at amortised cost or FVOCI • no longer separating embedded derivatives from their financial asset hosts. Instead, the entire instrument is assessed for classification • recognising financial asset fair value movements in profit or loss unless they are equity instruments not held for trading, which may be recorded in other comprehensive income • requirements to impair financial assets based on a three–stage 'expected' loss approach, which introduces a more forward looking provisioning model for recognising expected credit losses • requiring financial liabilities designated at fair value to recognise the effect of changes in the entity's own credit risk in other comprehensive income rather than profit or loss • a new chapter on hedge accounting, which includes a new model that is more closely aligned with risk management activities. The hedge effectiveness testing requirements are less complex and onerous. Key changes include: – allowing hedge accounting of risk components of non–financial items that are identifiable and measurable – changes to accounting for the time value of options, the forward element of a forward contract and foreign-currency basis spreads designated as hedging instruments	All entities for annual reporting periods beginning on or after 1 January 2018.

Overview	Applies to
– changes to the requirements for effectiveness testing (including removal of the ‘bright-line’ effectiveness test that offset for hedging must be in the range 80–125 per cent) • revised disclosures about an entity’s hedge accounting and expanded credit risk disclosures added to AASB 7 ‘Financial Instruments: Disclosures’.	
Entities’ responsibilities	
Entities should: • consider whether the standard will change their accounting policies for financial instruments • determine the system and information requirements they need to report under the new standard, or ensure existing systems and processes meet the requirements • prepare for the increased disclosures • consider the impact on reporting to stakeholders regarding the entity’s financial position and performance • comply with Treasury’s Policy and Guidelines Paper that will replace TPP 08-1 ‘Accounting for Financial Instruments’[1] • discuss proposed financial instruments policies and financial statement disclosures with the Audit and Risk Committees (ARC) and auditors • draft the disclosures required by AASB 108 for the initial application of AASB 9 • keep detailed working papers evidencing how they have complied with the new requirements, for example, the key decisions and judgements made, their classification of financial assets, impairment calculations and support for additional disclosures.	
Responsibilities of Audit and Risk Committees and those charged with governance	
ARCs and those charged with governance should: • understand the new standard • ensure management has complied with the requirements of AASB 9, including disclosing its initial application in the current year’s financial statements.	

Issue 2: AASB 15 ‘Revenue from Contracts with Customers’ and AASB 1058 ‘Income of Not for Profit Entities’

Overview	Applies to
AASB 15 ‘Revenue from Contracts with Customers’	
In December 2014, the AASB issued a new standard AASB 15 ‘Revenue from Contracts with Customers’. AASB 15 introduces a new five step-model for recognising revenue based on the principle that revenue is recognised when control of a good or service transfers to a customer. It will impact all entities providing goods or services under contract arrangements, especially those offering bundled products and services, providing warranties or rebates, or contracts with variable consideration. In May 2016, AASB 2016-3 ‘Amendments to Australian Accounting Standards – Clarifications to AASB 15’ amended AASB 15 to: • clarify the requirements for identifying performance obligations, principal versus agent considerations and the timing of revenue recognition from granting a licence • provide further practical expedients on transition to AASB 15.	For-profit entities for annual reporting periods beginning on or after 1 January 2018. Not-for-profit entities for reporting periods beginning on or after 1 January 2019.

[1] Does not apply to universities or their subsidiaries.

Overview	Applies to
The impact of AASB 15 on NFP entities should be considered in conjunction with the requirements in AASB 1058 (refer below).	
AASB 1058 'Income of Not-for-Profit Entities'	
AASB 1058 applies to: • transactions where consideration to acquire an asset is significantly less than fair value, principally to enable a NFP entity to further its objectives • receipt of volunteer services. On initial recognition of an asset an entity must recognise any related contributions by owners, increases in liabilities, decreases in assets and revenue ('related amounts') in accordance with other Australian Accounting Standards. Entities must immediately recognise the difference between the fair value of the asset and any related amounts as income in the profit and loss. However, if the transaction enables the entity to acquire or construct a recognisable non-financial asset controlled by the entity (i.e. an in-substance acquisition of a non-financial asset), the entity may recognise income as it satisfies its obligations under the transfer (similar to income recognition for performance obligations under AASB 15). A transfer of a financial asset to acquire or construct a recognisable non-financial asset controlled by the entity is one that: • requires the entity to use that financial asset to acquire or construct a recognisable non-financial asset to identified specifications • does not require the entity to transfer the non-financial asset to the transferor or other parties; and • occurs under an enforceable agreement. Local governments, government departments, general government sectors (GGSs) and whole of government must recognise volunteer services if: • they would have been purchased if not provided voluntarily • the fair value of those services can be measured reliably. For–profit entities will continue to account for grants and contributions under AASB 120 'Accounting for Government Grants and Disclosure of Government Assistance'. Full or modified retrospective application will be required on initial adoption of AASB 1058. The transitional provisions include practical expedients for completed contracts and assets acquired for consideration significantly less than fair value principally to enable the entity to further its objectives. Practical examples accompany AASB 1058 demonstrating how a NFP entity applies the requirements in practice.	NFP entities for annual reporting periods beginning on or after 1 January 2019.
Entities' responsibilities	
Entities should: • consider whether AASB 15 and AASB 1058 will change their income recognition policies. If it does, the impact must be disclosed before the application date, as either 'full' or 'modified' retrospective application will be required on adoption • assess and ensure registers/databases of contracts with customers are complete and identify performance obligations within those contracts • assess and ensure grants registers/databases are complete and identify whether the transaction enabled the entity to acquire or construct a recognisable non-financial asset controlled by the entity • prepare for the significantly increased disclosures	

Overview	Applies to
• review standard contract templates to ensure new contracts clearly support revenue recognition with the goods and services sold • ensure existing systems support income recognition and are capable of capturing the key information requirements of the new standards • ensure the control environment supports robust estimates and judgements on income recognition • consider the impact on reporting to stakeholders regarding the entity's financial position and performance • plan training for accounting staff, legal and sales teams • advise customers and other stakeholders if changes will be made to contracts, systems and processes • ensure proper guidance is provided to ARCs • discuss proposed income recognition policies and financial statement disclosures with their ARCs and auditors • consider and draft disclosures required by AASB 108 for the effects of AASB 15 and AASB 1058.	
Responsibilities of Audit and Risk Committees and those charged with governance	
ARCs and those charged with governance should: • understand AASB 15 and AASB 1058 and ensure management has adequately planned for their effective application, including disclosing the impact in the current year's financial statements • consider and confirm management's determination of whether to apply the new standards using a 'full' or a 'modified' retrospective approach • monitor progress against the plan and against the requirements of the standards.	

Issue 3: AASB 16 'Leases'

Overview	Applies to
In February 2016, the AASB issued a new standard AASB 16 'Leases'. AASB 16 eliminates the need for lessees to classify leases as either operating leases or finance leases. Leases will be 'capitalised' by recognising the present value of the future lease payments. Preparers can present leased assets in their financial statements in a separate category as leased (right-of-use) assets, or together with the property, plant and equipment category. Lessees will recognise a financial liability for their obligation to make future lease payments. The principal and interest portions of the cash payments will be separately disclosed in the Statement of Cash Flows. Lessees are not required to recognise assets and liabilities for: • short-term leases of 12 months or less • leases of low-value assets acquired for USD 5,000 or less. The new requirements will significantly increase right-of-use assets and related financial liabilities on lessees' balance sheets. Lessor accounting requirements are substantially carried forward from AASB 117 'Leases'. Accordingly, lessors will continue classifying leases as operating leases or finance leases, and accounting for them differently. Reporting entities will not have to restate comparative information when first applying AASB 16. On initial recognition, entities can choose how to measure leased assets that were previously	All entities for annual reporting periods beginning on or after 1 January 2019

Overview	Applies to
off-balance sheet. Leased assets can be measured as if AASB 16 had always applied, or at an amount based on the lease liability.	

Entities' responsibilities

Entities should:

- consider whether the standard will change their accounting policies for leases. The impact must be disclosed before the application date, as either 'full' or 'modified' as retrospective application will be required on adoption
- assess and ensure registers/databases of leases are complete
- determine the system and information requirements they need to report under the new standard, or ensure existing systems and processes meet the requirements
- prepare for the increased disclosures
- consider the impact on reporting to stakeholders regarding the entity's financial position and performance
- plan training for accounting and legal staff
- ensure proper guidance is provided to ARCs
- refer to TC18-05 'AASB Leases Transition elections' which prescribes the options NSW public sector entities are to elect when applying AASB 162
- discuss proposed lease policies and financial statement disclosures with their ARCs and auditors
- consider and draft disclosures required by AASB 108 for the effects of AASB 16.

Responsibilities of Audit and Risk Committees and those charged with governance

ARCs and those charged with governance should:

understand the new standard

- ensure management has adequately planned for its effective application, including disclosure of the impact in the current year financial statements
- monitor progress against the plan and against the requirements of the standard.

Issue 4: AASB 1059 'Service Concession Arrangement: Grantors'

Overview	Applies to
In July 2017, the AASB issued a new accounting standard AASB 1059 'Service Concession Arrangements: Grantors' to address the gap in accounting for service concession arrangements (SCAs) from the grantor's perspective. AASB 1059 applies to arrangements involving an operator providing public services related to a service concession asset on behalf of a public sector grantor for a specified period of time and managing at least some of those services. Common examples include roads, prisons, hospitals, water distribution facilities and energy supply. AASB 1059 will affect all public sector entity grantors (both for-profit and not-for-profit) involved in SCAs (including grantors of existing, but unrecognised SCAs). AASB 1059 requires a grantor to: • recognise an asset provided by the operator (including an upgrade to an existing asset of the grantor) as a service concession asset if the grantor controls the asset. The grantor controls the asset if they: – control or regulate the services the operator must provide with the asset, to whom it must provide them and at what price, and	All public sector entity grantors for annual reporting periods beginning on or after 1 January 2019, with early adoption permitted. The AASB has proposed amending the effective date of AASB 1059 from 1 January 2019 to 1 January 2020.

[2] Does not apply to universities or their subsidiaries.

Overview	Applies to

- control either a significant residual interest in the asset at the end of the arrangement, or control the asset for the whole of the life arrangement

- reclassify an existing asset (including recognising previously unrecognised identifiable intangible assets and land under roads) as a service concession asset when it meets the conditions specified above
- initially measure the service concession asset at current replacement cost (CRC) in accordance with AASB 13 'Fair Value Measurement'. After initial recognition or reclassification, account for the service concession asset in accordance with AASB 116 'Property, Plant and Equipment' or AASB 138 'Intangible Assets', as appropriate, except as specified in this Standard
- recognise a corresponding liability measured initially at the fair value (CRC) of the service concession asset, adjusted for any other consideration between the grantor and the operator; using either or both models (financial liability, or grant of a right to the operator) specified in the standard
- disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of assets, liabilities, revenue and cash flows arising from SCAs.

Grantors must apply AASB 1059 retrospectively:

- to each prior period presented under AASB 108 'Accounting Policies, Changes in Accounting Estimates and Errors', or
- by recognising and measuring service concession assets and related liabilities at the date of initial application (being the beginning of the earliest comparative reporting period presented).

Entities' responsibilities

Entities should:

- understand the requirements of the new standard
- assess the terms and conditions of existing arrangements with private sector operators to assess whether they fall within the scope of AASB 1059 and meet the criteria for recognition as a SCA or whether they are a leasing or outsourcing arrangements
- discuss their assessment with the ARC and auditors
- consider the impact of this issued, but not yet effective standard and make appropriate disclosures under AASB 108
- if an arrangement falls within the scope of AASB 1059, develop an implementation plan to apply AASB 1059.

Responsibilities of Audit and Risk Committees and those charged with governance

ARCs and those charged with governance should:

- understand the new standard
- review management's assessment of whether any current arrangements fall within the scope of AASB 1059
- If an arrangement falls within the scope of AASB 1059:
  - ensure management has adequately planned for its effective application, including disclosure of the impact in the current year financial statements
  - monitor progress against the plan and the requirements of the standard.

Other new financial reporting pronouncements

The following pronouncements, which may affect entity financial statements and/or annual reports, were issued3 between 1 January 2018 and 16 October 2018.

The table below does not include accounting standards issued during the period if an overview has already been provided in the table above.

Australian Accounting Standards

Reference/Title	Effective date	Standards amended/replaced
2018-1 'Amendments to Australian Accounting Standards – Annual Improvements 2015–2017 Cycle		
This Standard amends: • AASB 3 'Business Combinations' to clarify that an entity remeasures its previously held interest in a joint operation when it obtains control of the business; • AASB 11 'Joint Arrangements' to clarify that an entity does not remeasure its previously held interest in a joint operation when it obtains joint control of the business; • AASB 112 'Income Taxes' to clarify that an entity accounts for all income tax consequences of dividend payments according to where the entity originally recognised the past transactions or events that generated the distributable profits; and • AASB 123 'Borrowing Costs' to clarify what and when borrowing costs can be capitalised for the purpose of obtaining a qualifying asset.	Annual reporting periods beginning or after 1 January 2019 with early application permitted.	AASB 3, AASB 11, AASB 112 and AASB 123
2018-2 'Amendments to Australian Accounting Standards – Plan Amendment, Curtailment or Settlement		
This Standard amends AASB 119 'Employee Benefits' to specify how an entity accounts for defined benefit plans when a plan amendment, curtailment or settlement occurs during a reporting period. The amendments require an entity to use the assumptions used for the remeasurement of the net defined benefit liability or asset to determine the current service cost and the net interest for the remainder of the reporting period after a plan event occurs. The Standard also clarifies that, when a plan event occurs, an entity recognises the past service cost or a gain or loss on settlement separately from its assessment of the asset ceiling.	Annual reporting periods beginning or after 1 January 2019 with early application permitted.	AASB 119
2018-3 'Amendments to Australian Accounting Standards – Reduced Disclosure Requirements [AASB 16 & AASB 1058]'		
This Standard amends AASB 16 'Leases' and AASB 1058 'Income of Not-for-Profit Entities' to establish reduced disclosure requirements for entities preparing general purpose financial statements under Australian Accounting Standards – Reduced Disclosure Requirements (Tier 2).	Annual reporting periods beginning or after 1 January 2019 with early application permitted.	AASB 16 and AASB 1058
2018-4 'Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Public Sector Licensors [AASB 16 & AASB 1058]'		
This Standard amends AASB 15 'Revenue from Contracts with Customers' to add requirements and authoritative implementation	Annual reporting periods beginning or after 1 January 2019	AASB 15 and AASB 16

[3] Note this table only includes new standards issued and does not include compiled standards issued.

Reference/Title	Effective date	Standards amended/replaced
guidance for application by not-for-profit public sector licensors to transactions involving the issue of licences. The Standard also clarifies that licences that are in substance leases or contain leases, except licences of intellectual property, are within the scope of AASB 16 Leases.	with early application permitted provided that AASB 15 and AASB 16 are also applied to the same period.	

Australian Accounting Standards Board Practice Statements

Practice Statement 2 – Making Materiality Judgements

In December 2017, the AASB released Practice Statement 2 'Making Materiality Judgements' which provides reporting entities with guidance on making materiality judgements when preparing General Purpose Financial Statements (GPFS) in accordance with Australian Accounting Standards.

The Practice Statement:

- provides an overview of the general characteristics of materiality
- presents a four-step materiality process an entity may follow in making materiality judgements when preparing its financial statements
- provides guidance on how to make materiality judgements in specific circumstances (prior period information, errors, debt covenants and when preparing interim reports).

Treasury Publications

Treasury Circulars – refer to Treasury Website
TC 18-01 'Mandates of options and major policy decisions under Australian Accounting Standards'
TC 18-02 'NSW Fraud and Corruption Control Policy'
TC 18-05 'Leases Transition Elections'
TC 18-06 'Agency guidelines for the 2017-18 Mandatory Annual Returns to Treasury'
TC 18-07 'Machinery of government changes: Goods and Services Tax and Fringe Benefits Tax'
TC 18-08 'Goods and Services Tax (GST) treatment of certain government taxes, fees and charges'
TC 18-09 'Industrial Relations – Crown Employees (Public Sector – Salaries 2018) Award 2018'
TC 18-10 'Accounting for Superannuation'
TC 18-11 'Industrial Relations – Notional Salary 2018-19'
TC 18-12 'Industrial Relations – Crown Employees Wages Staff (Rates of Pay) Award 2018'
TC 18-13 'Accounting for Long Service Leave and Annual Leave'
TC 18-15 'Industrial Relations – Meal. Travelling and other Allowances for 2018-19'

Treasury Policy Papers – refer to Treasury Website
TPP 18-01 'Accounting Policy: Financial Reporting Code for NSW General Government Sector Entities'
TPP 18-02 'Commercial Policy Framework – Performance Reporting and Monitoring Policy for Government Businesses'
TPP 18-03 'NSW Government Foreign Exchange Risk Policy'
TPP 18-04 'Directors and Officers Indemnity Policy for State Owned Corporations'
TPP 18-05 'Major Projects Policy for Government Businesses'

Guidance – refer to Treasury Website
TCorp Foreign Exchange Execution Framework
Guidance for AASB 15 Revenue from contracts with customers
Guidance for AASB 1058 Income of not-for-profit entities
Overview on AASB 9 Financial Instruments

Other pronouncements by oversight bodies

Public Service Commission Circulars and Guides – refer to Public Service Commission Website
PSCC 2018-04 'Increase in Executive Remuneration of the Statutory and Other Offices Remuneration Tribunal'

Department of Finance, Services and Innovation – refer to Finance, Services and Innovation Website
PBD 2017-02 Procurement Board Direction 'Use of Procure IT for procurement of ICT goods and services'
PBD 2017-07 Procurement Board Direction 'Conduct by suppliers'

Other reporting issues

The table below details ongoing reporting issues that may impact your entity's financial statements. Management should review these issues, determine those applicable to the entity and assess the impact on the financial statements and annual report. Management may consult with their audit team for further information and explanation on the issues and developments detailed below.

Issue 1: Entities registered with the Australian Charities and Not-for-profit Commission (ACNC)

Overview	Applies to
Entities registered as a charity with the ACNC must meet ongoing obligations to: • keep records • report annually to the ACNC • notify the ACNC about certain changes • comply with governance standards. Registered charities' annual reporting obligations are based on the charity's size (classified according to annual revenue). All registered charities must submit an Annual Information Statement (AIS) containing both financial and non-financial information. Medium and large charities must also submit an audited annual financial report (review option available for medium charities audited outside of the *Public Finance and Audit Act 1983*). All registered charities must submit their AIS (and financial report if required) within six months of the end of the charity's reporting period. The ACNC may revoke an entity's registration for non–compliance with the above reporting requirements, resulting in the entity: • losing their ability to claim charity tax concessions • no longer being endorsed as a deductible gift recipient. All registered charities (except basic religious charities) must meet a set of governance standards to help promote public trust and confidence in charities. The ACNC website provides useful information and resources to help registered charities meet their obligations.	Entities registered with the ACNC.

Issue 2: Tax exemptions and concessions

Overview	Applies to
Government or semi government parent entities (such as universities) and their controlled entities should review the nature and purpose of each controlled entity to determine the validity of existing tax exemptions and concessions. Reviews should continue to: • examine the range of activities and services these entities deliver to determine whether they include 'unrelated commercial activities' where profits are not directed back to a charitable purpose • determine if entities should apply for, or confirm existing Australian Taxation Office (ATO) endorsement as income tax exempt funds or tax concession charities. The ATO NFP page provides useful information and guidance/tools to help NFP entities manage tax affairs.	NFP entities.

Issue 3: Donations and fundraising activities

Overview	Applies to
Recognition and recording of revenue from donations and other fundraising activities can be a significant risk. Often it is not possible to design and implement controls to ensure revenue is recognised and recorded in its entirety in the appropriate period. For example: • cash, cheques sent or other assets from donors resulting from an appeal for donations • activities that do not allow for complete record keeping, such as catered functions where attendees do not pre book. The audit opinion may be affected unless entities can demonstrate they have appropriate controls in place to ensure the completeness of revenue and that these controls are effectively designed and implemented, and have operated effectively throughout the reporting period. Auditing Guidance Statement GS 019 'Auditing Fundraising Revenue of Not for Profit Entities' provides useful guidance on controls an entity may establish over fundraising activities.	Entities that receive revenue from donations and other fundraising activities.

Professional people with purpose

OUR VISION

Our insights inform and challenge government to improve outcomes for citizens.

OUR MISSION

To help parliament hold government accountable for its use of public resources.

OUR VALUES

Purpose – we have an impact, are accountable, and work as a team.

People – we trust and respect others and have a balanced approach to work.

Professionalism – we are recognised for our independence and integrity and the value we deliver.

Level 15, 1 Margaret Street
Sydney NSW 2000 Australia

PHONE +61 2 9275 7100
FAX +61 2 9275 7200

mail@audit.nsw.gov.au

Office hours: 8.30am-5.00pm,
Monday to Friday.

auditoffice OF NEW SOUTH WALES

audit.nsw.gov.au