QUEENSLAND TREASURY

Financial Reporting Requirements for Queensland Government Agencies

For reporting periods beginning on or after 1 July 2017
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1.1   Introduction

These Financial Reporting Requirements for Queensland Government Agencies (FRRs), including the Sunshine Department Model Financial Statements and Future Bay Regional Health Foundation Model Financial Statements, have been issued to assist agencies in the preparation of their annual financial statements and to ensure consistency in presentation across agencies. The FRRs are not intended to duplicate or replace the Australian Accounting Standards Board (AASB) pronouncements, nor requirements of the Financial Accountability Act 2009 and the Financial and Performance Management Standard 2009. Therefore it is imperative that agencies comply with all relevant requirements in those documents when preparing their annual financial statements.

In instances where additional disclosures or modification of the model financial statements are imposed through an alternative authority, or would enhance transparency, accountability and user relevance, agency statements should be varied to the extent necessary but so as to still comply with the policies identified as mandatory throughout Parts 2-5 of the FRRs. If an agency believes that the requirements inhibit transparency and accountability or represent a departure from Australian Accounting Standards, the matter should be referred to Queensland Treasury's Financial Management Help Desk at fmhelpdesk@treasury.qld.gov.au.

These FRRs consist of six distinct parts including this introductory part (Part 1).

Part 2 – Basis of Preparation – containing mandatory policies and non-mandatory guidance on fundamental presentation matters regarding financial statements as a whole.


Part 5 – Other Disclosure Requirements – mandatory policies and non-mandatory guidance on topics beyond the scope of Parts 2-4.

Part 6A - Provides an example set of financial statements, the Sunshine Department Model Financial Statements, for those agencies that are consolidated into the whole-of-Government financial statements. These model statements comply with the FRRs and AASB pronouncements. To assist agencies in the preparation of their annual financial statements, a reference is located in the left hand margin of the Sunshine Department Model Financial Statements to the relevant FRRs, AASB standard or Australian Interpretation as the authority for the accounting or reporting treatment adopted in the model statements.

Part 6B - Provides an example set of financial statements, the Future Bay Regional Health Foundation Model Financial Statements, for statutory bodies that elect to adopt the AASB's reduced disclosure requirements (Tier 2), in accordance with FRR 2A.5. These model statements comply with the FRRs and Australian Accounting Standards – Reduced Disclosure Requirements. Consistent with the Sunshine Department Model Financial Statements, a reference is located in the left hand margin of the Future Bay Regional Health Foundation Model Financial Statements to the relevant FRRs, AASB standard or Australian Interpretation, as the authority for the accounting or reporting treatment adopted in the model statements.
1.2 Application

These FRRs apply to all departments. To the extent relevant, statutory bodies within the Queensland public sector must have regard to the policies identified as mandatory throughout Parts 2-5 i.e. statutory bodies must comply with the contents of the FRRs when they apply to statutory body circumstances. The FRRs do not apply to entities subject to the reporting requirements of the Corporations Act 2001.

For the purpose of the FRRs, all applicable reporting entities are referred to as 'agencies'.

1.2.1 Legislative Basis of Requirements

The Financial Accountability Act 2009 (FA Act) and its subordinate legislation, the Financial and Performance Management Standard 2009 (FPMS), provide the legislative basis for the requirement for departments and statutory bodies to prepare general purpose financial statements and prescribe the requirements under which these statements are prepared.

1.2.2 The Financial Reporting Framework

The FRR disclosure requirements and model financial statements are based on AASB pronouncements including:


- Statements of accounting concepts (SACs);

- Australian Accounting Standards; and

- Interpretations.

The Sunshine Department Model Financial Statements (Tier 1) and Future Bay Regional Health Foundation Model Financial Statements (Tier 2) are example ‘general purpose financial statements’. General purpose financial statements are intended to meet the needs of external users who rely on the information contained in the statements to assess the agency’s financial performance, financial position and cash flows. The model statements are based on three key principles:

- **Accountability** - The accountable officer/chief executive officer/chairperson of each agency is responsible for the efficient and effective use of the agency’s resources. An agency may also undertake trustee duties or duties as an agent for other entities. The financial statements of the agency are intended to fairly and truthfully represent such activities for the financial year.

- **Compliance** - Financial statements must comply with relevant legislation, applicable AASBs and other prescribed requirements, and the minimum reporting requirements (included in Parts 2-5) to the extent these apply to departments and statutory bodies.

- **Comparability** - Financial statements must provide information that is comparable between the current and previous financial years and on a cross-agency basis.
The Framework

The Framework sets out the:

- objective of general purpose financial reporting; and
- qualitative characteristics of useful financial information.

The various Australian Accounting Standards expand on the conceptual framework set out in the Framework and SAC 1 and addresses key issues on accounting and reporting that agencies must comply with.

SAC 1 Definition of the Reporting Entity

SAC 1 describes a reporting entity as an entity for which it is reasonable to expect the existence of users dependent on general purpose financial statements for the information which will be useful to them for making and evaluating decisions about the allocation of scarce resources.

SAC 1 also states that if an entity qualifies as a reporting entity, it should prepare general purpose financial statements in accordance with the SACs and AASBs.

Australian Accounting Standards

The AASB implemented the Financial Reporting Council's (FRC) policy of adopting the standards of the International Accounting Standards Board (IASB) for application to reporting periods beginning on or after 1 January 2005. The AASB continues to issue sector-neutral standards, that is, like transactions and events should be accounted for and reported in the same manner by all entities, regardless of their for-profit (FP) or not-for-profit (NFP) status.

Some accounting standards contain Australian-specific paragraphs, indicated at the start of the paragraph as 'Aus'. These ‘Aus’ paragraphs provide additional guidance for NFP entities whilst others contain alternative treatment to those in the corresponding IASB standard. If an entity adopts an 'Aus' accounting treatment, the entity will comply with the Australian Accounting Standards, in accordance with paragraph 7 of AASB 1054 Australian Additional Disclosures, but depart from the corresponding IASB standard. As such, the entity will not be able to make an explicit and unreserved statement of compliance with IFRS. A qualified statement of compliance with IFRS is not appropriate.

AASB Interpretations

The AASB has direct responsibility for developing and approving all Interpretations, including the formation of topic-specific advisory panels with the purpose of making recommendations for consideration by the AASB.

All Australian Interpretations have equal authoritative status and must be applied where relevant.
1.3 Australian Accounting Standards Board Pronouncements

This section clarifies which Australian Accounting Standards and Interpretations are applicable to the current reporting period, and which new and amended standards and interpretations have future application dates. Where new or amended accounting standards or interpretations contain any provisions likely to require early consideration and preparation/planning by most agencies, early advice of such amendments is also set out.

Agencies must comply with the latest prescribed accounting standards issued by the Australian Accounting Standards Board (AASB). ‘Prescribed accounting standards’ is defined in s.59(6) of the Financial Accountability Act 2009 to include the following documents published by the AASB: Australian Accounting Standards; Statement of Accounting Concepts; Interpretations; and the Framework for the Preparation and Presentation of Financial Statements. This section lists those accounting standards and interpretations that must be complied with by agencies.

Note that only limited detail has been provided regarding significant accounting changes. Each agency is expected to review all new/amended accounting standards and interpretations for the full ambit of changes and the consequences for their agency’s circumstances.

1.3.1 Treasury requirements re Australian Accounting Standards to apply to 2017-18 Reporting (based on standards issued as 31 May 2018)

Refer to the AASB website (http://www.aasb.gov.au/Pronouncements/Search-by-reporting-period.aspx) for clarification of the version of these standards applicable to this financial year.

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Refer to the AASB website [http://www.aasb.gov.au/Pronouncements/Search-by-reporting-period.aspx](http://www.aasb.gov.au/Pronouncements/Search-by-reporting-period.aspx) for clarification of the version of these interpretations applicable to this financial year.

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* Not applicable/relevant to departments or statutory bodies

1.3.3 Treasury requirements re New and Amended Accounting Standards and Interpretations to apply to Reporting Periods beginning on or after 1 January 2018 (based on standards and interpretations issued as at 31 May 2018)

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1.4 Significant Impacts on 2018-19 and Later Reporting Periods

1.4.1 AASB 9 Financial Instruments

AASB 9 will be applicable from reporting periods beginning on or after 1 January 2018, and it supersedes AASB 139 Financial Instruments: Recognition and Measurement. AASB 9 addresses recognition, classification, measurement and de-recognition of financial assets and financial liabilities, impairment of financial assets, hybrid contracts, and hedging. AASB 9 will also apply to statutory receivables, with guidance available in AASB 2016-8.

Note that AASB 7 Financial Instruments: Disclosures and AASB 132 Financial Instruments: Presentation will continue to be applicable (with updates) after AASB 9 becomes effective.

The most significant changes from AASB 139 are in these three areas:

1. Classification and measurement of financial assets and liabilities
2. Impairment of financial assets

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1 AASB 139 will still exist post 1 January 2018, but it will only contain hedging requirements for use by entities who choose, under AASB 9 paragraph 7.2.21, to continue to account for hedges under AASB 139. QT mandates that agencies apply the hedging requirements of AASB 9 after it becomes effective.
3. Hedging

The following sets out the key issues that will impact on most agencies. Agencies should undertake a comprehensive review of AASB 9 in 2017-18 to determine transitional impacts and if there are any other consequences for their own (current or possible future) circumstances.

1.4.1.1 Transitional arrangements

AASB 9 is to be applied retrospectively at the date of initial application (i.e. 1 July 2018 for agencies with a 30 June year-end). The standard allows, but does not require, restatement of prior periods where it is possible without the use of hindsight (paragraph 7.2.15). However, Treasury’s policy is that agencies shall not restate prior periods, even if it is possible without the use of hindsight. The net differences on initial application shall be recognised in opening accumulated surplus as at the date of initial application.

In addition, please note that:

- The standard shall not be applied to financial instruments that have already been derecognised at the date of initial application; and

- Hedge accounting requirements are to be applied prospectively, except for items specified in paragraph 7.2.26. If any agency has hedges of the type described in paragraph 7.2.26(b) that are material, please contact Treasury regarding the appropriate transitional policy.

Agencies who have designated financial assets or financial liabilities at fair value through profit or loss (FVTPL) to eliminate or significantly reduce an accounting mismatch under AASB 139 should reassess on transition whether the designation condition continues to be met. If no longer met, the agency must revoke the designation. On transition, agencies may also voluntarily revoke a previous designation at FVTPL, or designate a previously undesignated instrument (assuming conditions are met).

Agencies with hedging transactions must apply AASB 9’s hedge accounting requirements from 2018-19 onwards, and shall not choose under para 7.2.21 to continue to apply the hedge accounting requirements of AASB 139.

Disclosures

AASB 7 will require a number of one-off disclosures in the first reporting period in which AASB 9 is applied. Agencies should refer to the updated AASB 7 applicable to reporting periods beginning on or after 1 January 2018 for the detailed disclosures required on initial application of AASB 9 (paragraphs 42l-42s).

Agencies should also assess whether their systems are capable of providing the information necessary for the transitional disclosures and additional ongoing disclosures required by AASB 7.

1.4.1.2 Classification and measurement of financial assets and liabilities

Financial assets

Classification of financial assets will change from the four categories model under AASB 139 (FVTPL, loans and receivables, held-to-maturity investments and available-for-sale) to three measurement bases under AASB 9 (FVTPL, fair value through other comprehensive income (FVTOCI), and amortised cost). AASB 9 also uses new classification criteria. Agencies should conduct their own analysis of their financial assets to determine the appropriate classification and measurement requirements under AASB 9.

The classification of financial assets in AASB 9 is summarised in the following diagram.
Debt instruments
(e.g. trade receivables, loans, bonds, notes)

- Designation at FVTPL (where conditions met)
  - Yes
  - No

- Contractual cash flows / ‘SPPI’ test
  - Fail
    - Collect cash flows
  - Pass
    - Both sell & collect cash flows

- Business model test
  - Sell

- Amortised cost

Equity instruments
(e.g. shares)

- Held for trading
  - Yes
  - No

- Irrevocable election to use FVTOCI
  - No
  - Yes

- Fair value through OCI
  - With recycling
  - No recycling

- Fair value through profit or loss

**Debt instruments**

For debt instruments, such as trade receivables and loans receivable, there are two key tests to be applied to determine the measurement basis.

1. **Contractual cash flows test or “SPPI” test** – This test assesses whether the contractual terms of the financial asset give rise on specific dates to cash flows that are solely payments of principal and interest (“SPPI”) on the principal amount outstanding. For the purposes of considering whether interest meets this test, the most significant elements of interest within a basic lending arrangement are typically the consideration for the time value of money and credit risk.

   Consideration may also include compensation for other basic lending risks (e.g. administrative costs), however, if the contractual cash flows include consideration for aspects other than the basic lending risks and costs (e.g. exposure to equity returns, commodity prices, etc.) this test is failed and the financial asset must be measured at FVTPL. If the cash flows are solely payments of principal and interest, then the agency applies the business model test.

2. **Business model test** – This test assesses the objective of the business model within which the financial asset is held to determine the classification of financial assets that meet the contractual cash flows test.
If the business model objective is to hold financial assets in order to collect contractual cash flows, and the SPPI test is met, the financial asset is measured at amortised cost.

If the business model objective is achieved by both collecting contractual cash flows and selling financial assets, and the SPPI test is met, the financial asset is measured at FVTOCI. Gains and losses recognised in OCI are reclassified ('recycled') to profit or loss upon derecognition.

If the business model objective is other than the two above, e.g. an objective of realising cash flows through the sale of financial assets, the financial asset is measured at FVTPL.

Despite the new criteria, an agency may, at initial recognition, irrevocably designate a financial asset at fair value through profit or loss if this would eliminate or significantly reduce a measurement or recognition inconsistency (an accounting mismatch) that would otherwise result from measuring related assets and liabilities, or gains and losses on them, on different bases. For more guidance, see AASB 9 paragraphs B4.1.27-B.4.1.32.

Queensland Treasury’s view is that the measurement of cash and cash equivalents and short-term receivables held by departments and statutory bodies are not likely to need to change under the new requirements. Appendix B to AASB 9 contains substantial guidance about the circumstances where the business model and contractual cash flows criteria would and would not be met.

Some special types of debt instruments common in the public sector are considered below.

<table>
<thead>
<tr>
<th>Guidance</th>
<th>Likely classification / treatment</th>
</tr>
</thead>
</table>
| **Concessional interest or interest-free loans** | These loans are often provided with the intent of providing a benefit (the concessional component) to the borrower. When initially measuring the loan receivable at fair value, the agency should use an observable market interest rate for a loan of a similar amount, duration and security. For example:  
  - if the loan is secured by real estate, the agency can look at prevailing mortgage rates,  
  - if the loan is to an individual and is unsecured, the agency can look at unsecured personal loan rates.  
  As the market rate is higher than the concessional rate offered in the loan, the loan’s initial fair value will be less than the cash advanced. The difference is to be recognised as an expense in accordance with para 5.1.1A and B5.1.2A(a), and it will typically be classified as a grant expense.  
  With the concessional component separated out as an expense, the remaining financial asset will likely meet the criteria for amortised cost. | Loan classified at amortised cost and measured using an observable market interest rate, with the difference on initial measurement treated as grant expense |
| **Loans with contingent repayments** | Agencies need to consider the contractual conditions that determine or trigger the contingent payments, such as the borrower company achieving financial success with a product.  
  Where there is exposure to risks other than those expected in a basic lending arrangement (time value of money and credit risk), the loan is unlikely to meet the SPPI test, and will therefore be measured at FVTPL. | Loan classified at FVTPL |
Reclassification of financial assets will only be possible if an agency changes the business model for those financial assets, which is expected to be very infrequent. Appendix B to AASB 9 contains guidance about the circumstances that would and would not constitute a change in business model that would warrant reclassification of the associated financial assets. Any reclassifications will need to be accounted for prospectively from the reclassification date which is the beginning of the first reporting period after the change in the associated business model becomes effective.

**Equity instruments**

All investments in equity instruments that are within the scope of AASB 9 and contracts on those instruments will need to be recognised at fair value, as they will not satisfy the SPPI test. Unquoted equity instruments can no longer be measured at cost. Due to this change, agencies may find it useful to refer to an education paper issued by the International Financial Reporting Standards (IFRS) Foundation, titled IFRS 13 *Fair Value Measurement - Unquoted equity instruments within the scope of IFRS 9 Financial Instruments* – 


In relation to equity instruments that are not held for trading, AASB 9 allows an irrevocable election at the date of initial recognition (and at transition) to measure the equity instrument at FVTOCI. This election will mean the fair value fluctuations will not affect operating result, however some detailed additional disclosures will be required – see AASB 7 para 11A-11B. Treasury INTENDS TO PERMIT agencies to make this election on an instrument-by-instrument basis. Treasury will include example additional disclosures in the Sunshine Department model financial statements for agencies who choose to measure equity instruments at FVTOCI.

For equity instruments measured at FVTOCI, any dividends received are still recognised in the operating result (as normal), however fair value movements recognised in OCI will not be reclassified (‘recycled’) into operating result when the financial asset is derecognised.

**Financial liabilities**

The measurement requirements for financial liabilities are largely unchanged from those in AASB 139.

Key changes include:

- An agency may, at initial recognition, irrevocably designate a financial liability as at FVTPL if:
  - this would eliminate or significantly reduce a measurement or recognition inconsistency (an accounting mismatch) that would otherwise result from measuring related assets and liabilities, or gains and losses on them, on different bases; or
  - a group of financial liabilities - or financial assets and financial liabilities – is managed and its performance is evaluated on a fair value basis in accordance with a documented risk management or investment strategy. To meet this criterion, such performance information about that group would also need to be provided internally to the agency’s key management personnel.

- Fair value gains and losses due to changes in ‘own’ credit risk of liabilities designated at FVTPL must now be presented in other comprehensive income, rather than in operating result, unless it creates or enlarges an accounting mismatch.

- Derivative financial liabilities that are linked to and must be settled by delivering unquoted equity instruments can no longer be measured at cost, instead they must be measured at FVTPL.

- Financial guarantees and loan commitments for below-market rate loans are now measured at the higher of:
The amount of the loss allowance determined per the impairment requirements of AASB 9 (previously this was the provision amount determined under AASB 137), or
The amount initially recognised less income recognised in accordance with AASB 15.

Agencies should consider the impact of this change on any financial guarantees given to subsidiaries or related parties in deficit.

- AASB 9 will no longer allow reclassifications of financial liabilities.

On initial application of AASB 9, all existing financial instruments will need to be classified according to the AASB 9 criteria and transitional requirements, based on the facts and circumstances that exist at the date of initial application of that standard (i.e. as at the start of the first reporting period beginning on or after 1 January 2018).

### 1.4.1.3 Impairment of financial assets

AASB 9 introduces a new ‘expected credit loss’ model for determining impairment losses for financial assets. This new impairment model will be based on reasonable and supportable forward-looking information. It differs significantly from the impairment model in AASB 139 which is an ‘incurred loss’ model that only recognises impairment losses when there is objective evidence of impairment as a result of actual loss events occurring. Under the new model, a loss allowance will need to be recognised for all financial assets (although the amount may be very small or close to nil for high credit quality assets). Overall under AASB 9 impairment losses will be recognised earlier compared to AASB 139.

**Expected credit losses**

Expected credit losses are a probability weighted estimate of the present value of the difference between the cash flows that are due to the agency and the cash flows the agency expects to receive. A payment that is expected to be received in full, but late, also results in an expected credit loss, because the present values will be different (subject to materiality considerations). When measuring expected credit losses, agencies must also consider amounts expected to be recovered from any collateral, net of costs to obtain and sell the collateral, as this reduces the loss given default percentage. For example, the expected credit loss for a financial asset could be calculated as the amount outstanding (e.g. $100,000) x probability of default (e.g. 10%) x loss given default (e.g. 80%) = $8,000.

A key change from AASB 139 is the requirement to consider forward-looking information that is available without undue cost or effort. Agencies will need to apply significant judgement about how expected future changes in macroeconomic factors (e.g. economic growth, unemployment, household debt levels, etc.) will affect their measurement of expected credit losses.

Whilst Treasury is unable to provide forward-looking information or rates to meet every agency’s individual circumstances, various economic indicators by region (e.g. unemployment, building approvals, and the like) are published on the Queensland Government Statistician’s Office Website.

**Trend analysis** from these statistics and/or correlation of this information against actual defaults experienced by agencies (both historically and calculated as time progresses) may provide a useful basis from which agencies can making forward looking estimates/judgements (in the absence of specific events occurring which would also be taken into account).


12-month vs lifetime expected credit losses

The impairment allowance for financial assets is measured at either ‘12-month expected credit losses’ or ‘lifetime expected credit losses’. The flowchart below summarises the standard’s requirements and Treasury policies.

Trade receivables

AASB 9 allows a simplified impairment approach to always measure the impairment allowance at lifetime expected credit losses. This simplified approach is required for trade receivables and contract assets (arising from AASB 15) that do not contain a significant financing component (e.g. due within 12 months). In addition, Treasury INTENDS TO MANDATE the use of this simplified approach for trade receivables and contract assets that do contain a significant financing component. Therefore, agencies shall measure lifetime expected credit losses for all trade receivables and contract assets, and will not need to assess whether credit risk has increased significantly for these assets. Treasury INTENDS TO PROHIBIT the use of the simplified approach for lease receivables.

Guidance on estimating expected credit losses for trade receivables

Under AASB 9’s expected loss model, it will be insufficient to provide only for debtors that have evidence of impairment. Instead agencies must estimate expected credit losses for each receivable, including those that currently have no indicators of being uncollectible.

The most practical method to calculate expected credit losses for trade receivables will depend on the nature of the agency’s portfolio of debtors. Any agency with a small number of debtors may find it more efficient to assess each debtor individually. Alternatively, agencies with large portfolios can use a provision matrix as a practical expedient.

It is also important to distinguish disputed invoices from impaired debts. If a customer is disputing the validity of an invoice, the agency should assess whether the invoice was correctly raised in the first place. If not, then the receivable may need to be reversed against the original revenue account, rather than through impairment. If the agency believes the invoice is correct, the receivable is included in the impairment calculations.
Example 1 – Assessing trade receivables individually

The table below shows, for illustrative purposes only, example expected credit loss calculations for 8 trade receivables. This approach can be used by smaller agencies with few debtors.

<table>
<thead>
<tr>
<th>Debtor</th>
<th>Amount outstanding (A)</th>
<th>Probability of default (B)</th>
<th>Loss given default (C)</th>
<th>ECL (A x B x C)</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>$1,000</td>
<td>0.1%</td>
<td>100%</td>
<td>$1</td>
<td></td>
</tr>
<tr>
<td>B</td>
<td>$4,000</td>
<td>0.1%</td>
<td>100%</td>
<td>$4</td>
<td></td>
</tr>
<tr>
<td>C</td>
<td>$15,000</td>
<td>1.0%</td>
<td>20%</td>
<td>$30</td>
<td>Collateral is expected to cover 80% of the debt</td>
</tr>
<tr>
<td>D</td>
<td>$1,500</td>
<td>5.0%</td>
<td>100%</td>
<td>$75</td>
<td>Debt is 30 days overdue</td>
</tr>
<tr>
<td>E</td>
<td>$5,000</td>
<td>95.0%</td>
<td>100%</td>
<td>$4,750</td>
<td>Debt is 90+ days overdue and debtor has ceased trading</td>
</tr>
<tr>
<td>F</td>
<td>$10,000</td>
<td>25.0%</td>
<td>0%</td>
<td>$0</td>
<td>Debt is 90+ days overdue but collateral is expected to exceed the debt</td>
</tr>
<tr>
<td>G</td>
<td>$2,000</td>
<td>2.0%</td>
<td>100%</td>
<td>$40</td>
<td>Debtor’s liquidator advised the expected dividend receivable will be 25% of the debt (i.e.$500). But there’s also a 2% chance we won’t receive anything at all. N.B. An alternate calculation for Debtor G where there are two possible outcomes would be: (A) $2,000 x (B) 100% x (C) 75% = $1,500 plus (A) $500 x (B) 2% x (C) 100% = $10 giving the same total ECL of $1,510.</td>
</tr>
</tbody>
</table>

Total loss allowance is $6,373, resulting in a net receivables balance of $35,127.

Agencies with a large number of debtors do not need to assess each debtor individually. Instead, agencies can, as a practical expedient, use a provision matrix. A provision matrix assigns expected loss percentages to different aging bands of receivables to estimate the expected credit loss for the whole portfolio. The percentages are calculated based on historical credit loss experience, adjusted by current conditions and forward-looking data.

Agencies will also need to consider whether certain groups of debtors exhibit different loss patterns, and estimate loss rates separately for the different ‘customer’ groups. Groups of debtors for Queensland Government agencies would typically be based on geographic regions (illustrated below), different ‘products’ or differing customer types (e.g. different revenue streams for fines, goods or services with different characteristics and demonstrated loss patterns different from other revenue streams).

When determining historical credit loss rates, agencies should endeavour to use as much historical data as is available. Ideally, the period of historical data should cover a full economic cycle (e.g. at least 10 years). At a minimum, agencies would be expected to use at least five years of historical data (and longer periods if information is reasonably available in a cost-effective manner.)
Example 2 – Identifying debtor groups with similar loss patterns

The agency expects that debtors within certain geographic regions may have different defaults rates compared to average, in particular:

- A major mining operating in Region A had shut down earlier this year, resulting in uncertainty and high unemployment in the region.
- Region B relies heavily on its tourism industry. In the past number of years, due to environmental damage caused by a multiple weather events and the strong Australian dollar, tourism has fallen significantly in the region.

Based on this assessment, the agency decides it should calculate expected credit losses separately for Region A and Region B. In determining the expected loss rates (see Example 3 below), the agency noted that:

- Region A’s historical loss rates are not significantly different from that of other regions. However, the rates are increased to reflect current and expected future conditions for the region.
- Region B’s historical loss rates have been higher than that of other regions and the outlook for the region remains the same, no significant recovery is expected in the short term.

The example percentages are for illustrative purposes only.

<table>
<thead>
<tr>
<th></th>
<th>Current</th>
<th>1-30 days</th>
<th>31-60 days</th>
<th>60-90 days</th>
<th>&gt;90 days</th>
</tr>
</thead>
<tbody>
<tr>
<td>Region A debtors (higher losses)</td>
<td>0.6%</td>
<td>4.2%</td>
<td>11.8%</td>
<td>19.6%</td>
<td>39.0%</td>
</tr>
<tr>
<td>Region B debtors (higher losses)</td>
<td>0.5%</td>
<td>3.6%</td>
<td>9.6%</td>
<td>14.7%</td>
<td>33.9%</td>
</tr>
<tr>
<td>All other regions</td>
<td>0.3%</td>
<td>2.1%</td>
<td>5.9%</td>
<td>9.8%</td>
<td>19.5%</td>
</tr>
</tbody>
</table>

The following hypothetical example illustrates a step-by-step approach to calculating expected credit losses for trade receivables using a provision matrix.

Example 3 – Developing a provision matrix

Step 1 – Identify debtor groups with similar loss patterns (see Example 2 above)

An agency has three different revenue streams (A, B and C). Each stream has a different customer base and is processed using a different revenue system. The agency determines that it is appropriate to separately estimate expected loss rates for each revenue stream, due to different customer characteristics and loss patterns.

Step 2 – Obtain historical data

For revenue stream A, the agency has 10 years of available historical data on all debts issued and the subsequent collection or non-collection of those debts. The agency’s policy is to write off debts after they are over 90 days overdue, all reasonable recovery efforts have failed, and proper authorisation is obtained for the write off.
### All debts issued in the past 10 years

<table>
<thead>
<tr>
<th></th>
<th>100,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debts collected by due date</td>
<td>91,700,000</td>
</tr>
<tr>
<td>Debts collected between 1-30 days past due</td>
<td>6,200,000</td>
</tr>
<tr>
<td>Debts collected between 31-60 days past due</td>
<td>1,000,000</td>
</tr>
<tr>
<td>Debts collected between 61-90 days past due</td>
<td>600,000</td>
</tr>
<tr>
<td>Debts collected after 90 days overdue</td>
<td>350,000</td>
</tr>
<tr>
<td>Debts that were eventually uncollected</td>
<td>150,000</td>
</tr>
</tbody>
</table>

### Step 3 – Calculate historical loss rates

Using this data, the agency calculates the historical loss rates for each aging band by dividing the uncollectable debts by the total of debts that had cumulatively fallen within each aging category.

<table>
<thead>
<tr>
<th></th>
<th>All debts issued in the past 10 years</th>
<th>Historical loss rate</th>
<th>Forward-looking adjustment (5% increase)</th>
<th>Loss %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current</td>
<td>100,000,000</td>
<td>0.15%</td>
<td>0.01%</td>
<td>0.16%</td>
</tr>
<tr>
<td>1-30 days</td>
<td>Debts that had become overdue</td>
<td>8,300,000</td>
<td>1.81%</td>
<td>1.90%</td>
</tr>
<tr>
<td>31-60 days</td>
<td>Debts that had become &gt;30 days overdue</td>
<td>2,100,000</td>
<td>7.14%</td>
<td>7.50%</td>
</tr>
<tr>
<td>61-90 days</td>
<td>Debts that had become &gt;60 days overdue</td>
<td>1,100,000</td>
<td>13.64%</td>
<td>14.32%</td>
</tr>
<tr>
<td>90+ days</td>
<td>Debts that had become &gt;90 days overdue</td>
<td>500,000</td>
<td>30.00%</td>
<td>31.50%</td>
</tr>
<tr>
<td></td>
<td>Debts that were eventually uncollected</td>
<td>150,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Step 4 – Apply forward-looking adjustments

The agency then considers forecasts of macroeconomic conditions such as unemployment rates and interest rates and their expected impacts on the default rates of revenue stream A customers. Using this forward-looking information, it expects slightly higher loss rates on its current debtor portfolio than the average for the past 10 years. The agency adjusts its historical loss rates upwards by 5% to take this into account.

<table>
<thead>
<tr>
<th></th>
<th>Historical loss rate</th>
<th>Forward-looking adjustment (5% increase)</th>
<th>Loss %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current</td>
<td>0.15%</td>
<td>0.01%</td>
<td>0.16%</td>
</tr>
<tr>
<td>1-30 days</td>
<td>1.81%</td>
<td>0.09%</td>
<td>1.90%</td>
</tr>
<tr>
<td>31-60 days</td>
<td>7.14%</td>
<td>0.36%</td>
<td>7.50%</td>
</tr>
<tr>
<td>61-90 days</td>
<td>13.64%</td>
<td>0.68%</td>
<td>14.32%</td>
</tr>
<tr>
<td>90+ days</td>
<td>30.00%</td>
<td>1.50%</td>
<td>31.50%</td>
</tr>
</tbody>
</table>

### Step 5 – Calculate the loss allowance
Finally, the agency applies the adjusted loss percentages to the gross carrying amount of its debtors within each aging band to calculate the total lifetime expected credit losses for its revenue stream A debtors.

<table>
<thead>
<tr>
<th>Debtor gross carrying amount</th>
<th>Loss %</th>
<th>Lifetime expected credit losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current</td>
<td>1,234,000</td>
<td>0.16%</td>
</tr>
<tr>
<td>1-30 days</td>
<td>97,000</td>
<td>1.90%</td>
</tr>
<tr>
<td>31-60 days</td>
<td>31,000</td>
<td>7.50%</td>
</tr>
<tr>
<td>61-90 days</td>
<td>120,000</td>
<td>14.32%</td>
</tr>
<tr>
<td>90+ days</td>
<td>8,000</td>
<td>31.50%</td>
</tr>
<tr>
<td><strong>Loss allowance:</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The agency can use a similar method for its revenue streams B and C debtors. Also, in the following year, the agency will have 11 years of historical data for revenue stream A and accordingly will use 11 years of data to calculate new historical loss rates.

**Notes:** If an agency does not have the type of data described in Step 2 of Example 3 above, it can instead use historical monthly debtor aging tables to calculate average roll over rates. For example, the average percentage of current debts that become 1-30 days overdue in the next month, the average percentage of 1-30 days overdue debts that become 31-60 days overdue debts that become 31-60 days overdue in the next month, and so on.

The forward-looking adjustment, as applied in Step 4 of Example 3 above, can be an increase, nil, or a decrease. It can be a decrease if the agency expects better future economic conditions than the period represented by the agency’s historical data. This may be the case if the agency’s historical data covers a period of economic downturn, and the economy has since recovered.

**Other financial assets (e.g. loans and advances, lease receivables, debt securities)**

On initial recognition of a financial asset other than trade receivables or contract assets, the loss allowance for that instrument should reflect the ‘12-month expected credit losses’. 12-month expected credit losses are the expected credit losses that result from default events that are possible within 12 months after the reporting date. This means the lifetime cash shortfalls that will result if a default occurs in the 12 months after the reporting date, weighted by the probability of a default occurring in that period. The probability of default within 12 months may be lower than the probability of default over the life of the financial asset, therefore resulting in a lower loss allowance.

If there is a significant increase in credit risk, the impairment allowance will need to reflect lifetime expected losses. AASB 9 paragraphs B5.5.15-21 contain guidance on whether the credit risk on a financial asset has increased significantly since initial recognition. For this purpose, agencies may assume that

- credit risk has increased significant if the financial asset is more than 30 days past due, and that
- credit risk has not increased significantly if the financial asset is determined to have low credit risk at reporting date.

Agencies should not take into account the existence of any collateral when assessing whether credit risk as increased significantly.
For these financial assets, agencies will also need to assess, on initial application of AASB 9, whether credit risk has increased significantly. Agencies must determine the credit risk at the date that the financial assets were initially recognised, and compare that to the credit risk at the date of initial application of AASB 9, based on reasonable and supportable information that is available at the date of initial application. Agencies may need to implement new internal processes to identify changes in credit risk of their financial assets.

**Inter-agency receivables**

Inter-agency loans and receivables between Queensland Government agencies are expected to have an insignificant, and therefore immaterial, level of credit risk exposure due to the high credit rating of the State. Consequently, Treasury’s proposed policy is that departments and statutory bodies will not measure any loss allowance for receivables collectible from other Queensland Government Agencies controlled by the Queensland Government for financial reporting purposes (i.e. departments, statutory bodies, Government-Owned Corporations and the like but excluding universities and local government entities) on the grounds of materiality. (Receivables from universities and local government entities should be considered as part of assessing ‘external’ receivables.) Inter-agency receivables should be assessed individually and confirmed with the relevant agency to ensure agreement between the agencies on the amount of the debt.

There may sometimes be disputes around the validity of inter-agency receivables (i.e. whether a debt is owed at all) or the amounts receivable/payable. In these situations, the lender agency should first talk to the borrower agency to identify the reason for the dispute and to clarify the existence or value of the debt. The agencies involved can seek Treasury advice if needed. The resolution of the issue may result in the lender agency de-recognising or writing down the receivable. This will not be an impairment loss, instead the debit will be to another account, such as the account initially credited when the receivable was recognised. An alternate resolution may be that the borrower agency agrees to settle the debt.

Agencies are otherwise recommended to consult with Treasury before recognising an impairment loss on an inter-agency receivable.

**Write-offs**

AASB 9 specifies a financial asset should be written off in the financial statements when the entity has no reasonable expectation of recovering the financial asset. A write off involves reducing the gross carrying amount of a receivable against the impairment allowance, or impairment loss if the allowance was insufficient.

Currently, most agencies are writing off financial assets when the appropriate authorisation required by the *Financial Accountability Act 2009* (FA Act) is obtained in line with their established delegations and processes.

When AASB 9 becomes effective, disclosure will be required under AASB 7 of:

- The entity’s write-off policy, including indicators that there is no reasonable expectation of recovery
- Policy for financial assets that are written off but are still subject to enforcement activity
- Amounts written off during the year that are still subject to enforcement activity

The Accounting Standards and Treasury cannot dictate when the accountable officer should write-off losses under the FA Act or when the agency should cease enforcement activity. However, agencies may wish to review their current write-off policies/practices and consider how these will be disclosed under AASB 7, including circumstances where enforcement activity continues, or is likely to continue, after a write-off has occurred.
Recognising interest income

As a result of the change from an "incurred loss" model to an "expected loss" model, there are some consequential changes to the effective interest method and recognition of interest income.

- The definition of effective interest rate (EIR) is updated to refer to the gross carrying amount of a financial asset, rather than the amortised cost (net carrying amount) which is used in AASB 139.
  - The EIR is determined without taking into account any expected credit losses, this is the same as AASB 139.

- For non-credit impaired financial assets, interest is recognised by applying the effective interest rate to the gross carrying amount.
  - This means full interest income is recognised even if there is some impairment loss for the financial asset. This is the case even if the financial asset has experienced a significant increase in credit risk, as long as it is not yet credit impaired.

- After a financial asset becomes credit impaired, interest is recognised by applying the effective interest rate to the amortised cost (net carrying amount).
  - This means interest is only recognised on the net carrying amount (i.e. non-impaired portion) of the financial asset.
  - The definition of credit impaired is substantially the same as when financial assets become impaired in AASB 139 (paragraph 59).

Despite these new requirements, recognition of interest income is not expected to differ significantly from AASB 139 in practice – see AASB 139 paragraphs 9, 46, AG5 and AG93.

Summary of the 'three-stage' approach

The following table summarises AASB 9 requirements and Treasury policies around measurement of expected credit losses and recognition of interest income.

<table>
<thead>
<tr>
<th>Stage 1</th>
<th>Stage 2</th>
<th>Stage 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>No significant increase in credit risk</td>
<td>Significant increase in credit risk, but not yet credit impaired</td>
<td>Credit impaired</td>
</tr>
<tr>
<td>Expected credit losses</td>
<td>Life time expected credit losses</td>
<td>12-month expected credit losses</td>
</tr>
<tr>
<td>Trade receivables and contract assets</td>
<td></td>
<td>Lifetime expected credit losses</td>
</tr>
<tr>
<td>Other financial assets, e.g. loans, lease receivables, bonds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest income</td>
<td>Apply effective interest rate (EIR) to the gross carrying amount</td>
<td>Apply EIR to the net carrying amount</td>
</tr>
</tbody>
</table>
1.4.1.4 Hedging

The revised hedge accounting requirements included in AASB 9 reflect a substantial change from the corresponding requirements in AASB 139. The objective of hedge accounting is to represent in the financial statements the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect the operating result. The revised requirements are more principles-based rather than rules-based, and focus on an entity's risk management. Key changes are at a high level are:

- The '80-125%' hedge effectiveness test has been removed. Under AASB 9, hedge accounting can be used as long as there is an economic relationship between the hedged item and the hedging instrument, credit risk does not dominate the value changes, and the hedge is formally designated and documented.

- If a hedge becomes ineffective, an entity can ‘rebalance’ the hedge by adjusting the hedge ratio (the relative weighting of the quantities of the hedging instrument and the hedged item designated in the hedge) so that the hedge becomes effective again. A hedge can be rebalanced as many times as necessary, as long as the risk management objective for the hedge remains the same, to allow continued use of hedge accounting.

- It will be possible to designate as a hedged item a specific risk component of a non-financial item, provided the risk component is separately identifiable and reliably measurable. AASB 139 permits this only for hedged items that are financial instruments.

- It will be possible to designate more groups of items as hedged items, such as a net position and a layer component of a group of items.

- For a fair value hedge involving an equity instrument measured at FVTOCI, the gains and losses of both the hedging instrument and hedged item are recognised in OCI.

- For a cash flow hedge of a forecast transaction that results in a non-financial asset, the gain or loss on the hedging instrument that is stored in the cash flow hedge reserve must be included in the initial carrying amount of the asset. AASB 139 has an option to reclassify the gain or loss into operating result in the period/s in which the acquired asset affects the operating result, this option is removed in AASB 9.

1.4.1.5 Disclosures – changes to AASB 7

AASB 7 Financial Instruments: Disclosures has had significant consequential amendments arising from AASB 9, they will become effective at the same time as AASB 9 (1 January 2018). The required disclosures about financial assets and financial liabilities will change, depending on the measurement and accounting treatment of those assets and liabilities after application of AASB 9. The most significant impacts on disclosures will be in respect of:

- the credit risk of financial assets (to which the impairment requirements in AASB 9 apply) – agency's credit risk management practices, quantitative and qualitative information about expected credit losses, and information about an agency's credit risk exposure;

- investments in equity instruments designated to be measured at fair value through other comprehensive income, and de-recognition of these investments;

- reclassifications of financial assets resulting from a change in business model;

- de-recognition of financial assets measured at amortised cost – an analysis of gains and losses recognised in the operating result (showing gains and losses separately), and reasons for the de-recognition; and

- hedge accounting – agency's risk management strategy, the amount, timing and uncertainty of future cash flows, and the effects of hedge accounting on financial position and performance.
1.4.2 AASB 16 Leases

AASB 16 Leases will become effective for reporting periods beginning on or after 1 January 2019 and will replace AASB 117 Leases, Interpretation 4 Determining whether an Arrangement contains a Lease, Interpretation 115 Operating Leases – Incentives and Interpretation 127 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

AASB 16 applies to all leases (see ‘Identifying a lease’ section below), except for those arrangements listed in paragraph 3. In addition, Treasury’s policy is that agencies shall not apply AASB 16 to leases of intangible assets.

All agencies with leases should commence reviewing AASB 16 to become familiar with the new requirements. There will likely be a significant balance sheet impact for agencies with a material number/amount of operating leases.

1.4.2.1 Transitional arrangements

The date of initial application of AASB 16 is 1 July 2019 for agencies with a 30 June year end.

Treasury INTENDS TO MANDATE the practical expedient in paragraph C3 of AASB 16 that allows agencies to not have to re-assess whether existing contracts contain a lease. This means that contracts that were leases under AASB 117 and Interpretation 4 will be accounted for as leases under AASB 16 on transition, and contracts that were not leases under AASB 117 will continue to not be accounted for as leases. The new criteria in AASB 16 for identifying a lease will be applied for all new leases and lease modifications from the date of initial application.

Lessees

Treasury INTENDS TO MANDATE the modified retrospective approach in paragraph C5(b). Under this transition approach, agencies will not need to restate comparative figures in their 2019-20 financial statements. For leases that were operating leases under AASB 117, agencies will measure their new lease liability at 1 July 2019 by discounting the remaining lease payments at the agency's incremental borrowing rate.

AASB 16 allows lessees to choose, on a lease-by-lease basis, between measuring the right-of-use asset either as if the standard had always applied (paragraph C8(b)(i)) or at an amount equal to the lease liability (paragraph C8(b)(ii)). The difference between the two options are:

- C8(b)(i) will result in a lower initial asset value, meaning a reduction in net assets at the date of transition but lower depreciation expense in future years. This option is more complicated, especially for leases that have had variable rent increases.
- C8(b)(ii) will result in a higher initial asset value, meaning minimal impact on net assets at the date of transition but higher depreciation expense in future years.

Treasury recommends that agencies use option C8(b)(i) where the historical information is available, as this will reduce the operating result impact in future years. Option C8(b)(ii) can be used where the necessary information is not available, for example for leases originally entered into by another agency and transferred to the current lessee via a machinery of government change.

On transition, any lease incentives liabilities and assets or liabilities from straight-line accounting of operating leases will be derecognised, against either opening retained earnings under option C8(b)(i), or the right-of-use asset under option C8(b)(ii).
Treasury INTENDS TO PERMIT agencies to use any/all of the practical expedients available in paragraph C10 on a lease-by-lease basis.

**Lessors**

On transition, lessors need to reassess the classification of their subleases that were operating leases under AASB 117, by applying the new requirements in AASB 16 paragraph B58. If the lease is now a finance lease under AASB 16, the agency accounts for it as a new finance lease commencing at the date of initial application. There are no other transitional impacts for lessors.

**1.4.2.2 Identifying a lease**

The new definition of a lease under AASB 16 is “a contract, or part of a contract, that conveys the right to use an asset for a period of time in exchange for consideration”. A contract conveys the right to use an asset where there is an identified asset, and the customer/lessee has:

- a) the right to obtain substantially all of the economic benefits from use of the asset, and
- b) the right to direct the use of the asset (i.e. direct how and for what purpose the asset is used).

The concept of identified asset is substantially the same as a ‘specified asset’ in Interpretation 4. AASB 16 provides more guidance about when the supplier has substantive substitution rights and when a capacity portion of an asset is an identified asset.

The new criteria above that establish a right to control the use of the asset differ from those in Interpretation 4 paragraph 9. AASB 16’s control approach requires both a ‘benefits’ element and a ‘power’ element, consistent with other recent standards. This could, for example, result in arrangements that were leases under Interpretation 4 no longer being leases under AASB 16.

Agencies should gain an understanding of how to identify a lease under AASB 16, in particular paragraphs B9 to B30 and the flowchart in B31 are useful resources. Note that Treasury’s policy is that, on transition, agencies do not need to reassess all of their contracts to determine whether they are leases under AASB 16 or not (see paragraph C3). **Agencies will only apply AASB 16’s new ‘identifying a lease’ concepts to leases commencing (or modified) on or after 1 July 2019.**

For public-private partnerships (PPP) that are currently accounted for as leases, agencies must determine whether they are service concession arrangements under AASB 1059 Service Concession Arrangements: Grantors, which comes into effect in the same year as AASB 16. This can result in a reclassification of the arrangement. Refer to section 1.4.5 below for details about AASB 1059.

**1.4.2.3 Impacts for lessees**

Unlike AASB 117, AASB 16 introduces a single lease accounting model for lessees. There will no longer be a distinction between finance leases and operating leases for lessees. Lessees will be required to recognise on balance sheet a right-of-use asset (representing the right to use the underlying leased asset) and a lease liability (representing the obligation to make future lease payments) for all leases except for the two exemptions below.

**Recognition exemptions**

1. **Short-term leases** – A short-term lease has a lease term of 12 months or less and does not have a purchase option. Treasury’s intended policy is agencies **must** apply the exemption for short-term leases of all classes of underlying assets.
2. Leases of low value assets – This exemption can be applied on a lease-by-lease basis. Treasury INTENDS TO MANDATE set the “low value asset” threshold at AUD $10,000. This threshold is applied to the value of the asset when new, regardless of the age of the asset being leased. For example, new cars in Australia cost more than $10,000, so cars are not low value assets and leases of cars will need to be brought on balance sheet, unless it is a short-term lease. For leases of low value assets (assets that cost less than $10,000 when new), agencies may choose whether to account for them on balance sheet. Examples of low value assets include tablets, personal computers, small items of office furniture and phones.

When a recognition exemption is applied to a lease, the lease is accounted for similar to an operating lease under AASB 117, by recognising the lease payments as an expense typically on a straight-line basis over the lease term.

It is expected that the majority of (what are currently classified as) operating leases will be reported on the Statement of Financial Position under AASB 16, potentially resulting in a significant increase in assets and liabilities for agencies. The scale of the increase in assets and liabilities would be somewhat in proportion to the scale of the agency’s operating leases.

**Separating components of a contract**

A lease contract can also include non-lease components such as maintenance services or supplies of consumables. The lessee is ordinarily required to separate out the lease and non-lease components and allocate the consideration to the components based on their relative stand-alone prices. The non-lease components are then accounted for under other applicable standards.

A practical expedient in paragraph 15 allows lessees to elect, by class of underlying asset, to not separate non-lease components from lease components, and instead account for them as a single lease component. This will result in a higher right-of-use asset and lease liability, but may require less effort. Treasury’s intended policy with regards to this practical expedient is:

- agencies shall apply the practical expedient (i.e. shall not separate out non-lease components) for leases of Plant and Equipment, and
- agencies shall not apply the practical expedient (i.e. shall separate out non-lease components) for leases of all other classes of assets as defined in NCAP 1.

**Lease liability**

The lease liability will be initially recognised at an amount equal to the present value of the lease payments during the lease term that are not yet paid. Operating lease payments will no longer be classified as operating expenses (e.g. rent expense). Instead, these payments will be apportioned between a reduction in the lease liability and a finance charge calculated at the applicable discount rate. The finance cost will be recognised as an expense.

When measuring the lease liability, agencies should note the following areas where additional care and judgement may be required.

**(a) Determining the lease term**

It is important to correctly assess the lease term as only those lease payments during the lease term are included in the liability measurement. Lease term is the non-cancellable period plus extension periods that the lessee is reasonably certain to exercise and early termination periods that the lessee is reasonably certain not to exercise. “Reasonably certain” should reflect a very high probability. The lease term concept in AASB 16 is similar to AASB 117. However, under AASB 16 the lease term can be revised throughout the lease, whereas in AASB 117 the lease term was set based on the lessee’s intentions at the inception of the lease. Also, ‘at market’ renewal options would be considered under AASB 16 and added to the lease term once its exercise becomes reasonably certain.
For example, an agency enters into a 5 year lease of a building with a 2 year extension option, and the agency can cancel the lease at any time without penalty by giving 12 months’ notice. In this case:

- The minimum non-cancellable period is 12 months.
- The agency must assess whether it is reasonably certain to not terminate the lease before the 5 year lease term is up. The agency determines that it is reasonably certain to lease the building for the full 5 years (i.e. not terminate early), so it adds an additional 4 years to the lease term.
- The agency then assesses whether it is reasonably certain to exercise the 2 year extension option. It determines that it is not reasonably certain to extend, so the lease term remains at 5 years.

While the assessment of lease terms takes into account the intentions of the lessee, sometimes agencies do not have full control over their lease decisions. This may be the case for some internal Government agency leases (e.g. leases of office space from the Department of Housing and Public Works). Subject to any future developments in internal leasing arrangements, Treasury’s present guidance for such leases is the lessee may presume (unless there is a separate agreement between the two agencies or other compelling evidence to the contrary):

(a) the lessee will not terminate the lease early; and

(b) the lessee is not reasonably certain to exercise any extension options, and should therefore use the standard lease term stated in the lease agreement.

If agency management has made a decision to terminate a lease early, they should inform DHPW on a timely basis to ensure the same lease term is used in accounting for the lease by both parties.

(b) Fixed vs variable rent escalation clauses

Rent escalation clauses that provide for a fixed percentage or dollar increase per year are included in the initial measurement of the lease liability. This is no different from AASB 117.

Rent escalation clauses that depend on a future index or rate (e.g. consumer price index or market rentals) are considered variable lease payments. In contrast with AASB 117 where such payments are called ‘contingent rent’ and are expensed as incurred, AASB 16 requires these variable lease payments that depend on an index or rate to be included in the measurement of the lease liability. However, unlike fixed rent increases, these increases are only included in the liability measurement when there is a change in cash flows. Agencies should not attempt to estimate/predict future variable increases, and instead should assume no change (0% increase) until the future change happens.

For example, if rent increases on 1 July each year following a market rent review, the liability is remeasured on 1 July when the increased rent payment takes effect. At 30 June of the previous year, the lease liability does not take into account this increase, even if the lessee knows what the increase will be.

(c) Using the appropriate discount rate

On transition, Treasury INTENDS TO MANDATE the ‘modified retrospective’ approach in paragraph C5(b). This means agencies must use their incremental borrowing rate to calculate the lease liability on transition for what were previously considered operating leases.

For new leases entered into after the transition date, the discount rate used to calculate the present value of the lease liability is the interest rate implicit in the lease, if that rate can be readily determined, or if not, the lessee’s incremental borrowing rate. Calculating the interest rate implicit in the lease requires some information that may
only be available to the lessor. On this basis, Treasury’s proposed guidance is that if the interest rate implicit in the lease is specified in the lease agreement or otherwise provided by the lessor, agencies should use that rate, otherwise agencies can use their incremental borrowing rate.

Incremental borrowing rates could differ between leases of the same agency, for example between a 3-year lease and a 15-year lease. Treasury’s intended policy for incremental borrowing rates is that agencies shall use QTC’s Fixed Rate Loan rates that correspond with the lease commencement month and lease term. QTC’s Fixed Rate Loan borrowing rates can be accessed using the QTC Link website.

Right-of-use asset

The right-of-use asset will be initially recognised at cost, comprising of

- the initial amount of the associated lease liability,
- any lease payments made to the lessor at or before the commencement date, less any lease incentives received,
- any initial direct costs incurred by the lessee, and
- an initial estimate of future make-good costs, e.g. dismantling, removal and restoration.

The right-of-use asset is then depreciated over the lease term, or the underlying asset’s useful life where circumstances suggest the lessee will use the asset for its entire useful life (see paragraph 32). AASB 136 Impairment of Assets will also apply to right-of-use assets.

Treasury considers measuring the right-of-use asset at fair value will not provide relevant or useful information to financial statement users given the benefit of the right-of-use asset is for providing ongoing service delivery. Further, the cost of determining a fair value would far outweigh the resulting benefit. Consequently, Treasury’s PROPOSES TO MANDATE the accounting policy that agencies shall not apply the revaluation model to right-of-use assets and measure the right-of-use asset at cost. (In some cases, the amortised cost of the right-of-use asset will approximate fair value.)

Where there are variable rent increases, the right-of-use asset is adjusted when the lease liability is remeasured. In practice, this may mean the carrying amount of the right-of-use asset is increased each year when the rent increase takes place, and depreciation also needs to be adjusted accordingly.

Presentation

Treasury will provide guidance in future updates to agencies regarding the presentation and disclosure of the right-of-use asset and lease liability in agency financial statements.

1.4.2.4 Impacts for lessors

Lessor accounting under AASB 16 remains largely unchanged from AASB 117. For finance leases, the lessor will continue to recognise a receivable equal to the net investment in the lease. Lease receipts from operating leases will continue to be recognised as revenue either on a straight-line basis or another systematic basis where appropriate.

Sublease classification

AASB 16 brings a minor change relevant to agencies with subleases. When classifying a sublease as a finance lease or operating lease, reference is made to the right-of-use asset arising from the head lease, rather than the
underlying asset. This means, for example, the sub-lessor would assess whether the lease term of the sublease is for the major part of the economic life of the right-of-use asset (i.e. the lease term of the head lease). E.g. an agency leases a building with a 40-year useful life for 15 years and subleases it to another party for 10 years, when classifying the sub-lease the agency would compare the 10 years with the 15 years. This can result in some subleases that were operating leases under AASB 117 becoming finance leases in AASB 16.

Additionally, if the head lease is a short-term lease, then the sublease must be classified as an operating lease.

1.4.2.5 Contracts review and data collection

Treasury strongly recommends that agencies with material leasing activities undertake a review of their lease agreements in 2017-18 and collect data about those leases to understand the transitional impacts of AASB 16 for their agency. The focus should be on operating leases, as they are subject to more significant changes. The following table provides guidance on what to look for when reviewing your lease contracts.

To assist agencies, Treasury has also developed the QT Leases Contract Review and Data Collection Worksheet, included as an Appendix to FRR 1A.

<table>
<thead>
<tr>
<th>Guidance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Is there a lease?</strong></td>
</tr>
<tr>
<td><strong>Value of the leased asset</strong></td>
</tr>
<tr>
<td><strong>Commencement date</strong></td>
</tr>
<tr>
<td><strong>Lease term</strong></td>
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<tr>
<td><strong>Lease incentives</strong></td>
</tr>
<tr>
<td>Guidance</td>
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<tr>
<td>------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td><strong>Non-lease components</strong></td>
</tr>
<tr>
<td>Agencies will need to identify any non-lease components (e.g. cleaning, maintenance, consumables, operating expenses) and exclude payments relating to those components from the calculation of the lease liability. If there is an insufficient breakdown of the payments in the contract, the agency can either ask the lessor to provide the information (if practical), or allocate the payments based on an estimate of the stand-alone prices of the lease and non-lease components. Payments for non-lease components are typically expensed when incurred. The exception is for leases of plant and equipment (an asset class defined in NCAP 1). Treasury’s policy for these leases is that agencies shall not separate out non-lease components. This means payments for the non-lease components are included in the measurement of the lease liability, and consequently the right-of-use asset.</td>
</tr>
<tr>
<td><strong>Interest rate implicit in the lease</strong></td>
</tr>
<tr>
<td>If the discount rate is specified in the lease agreement, agencies should record it. However, this rate will <strong>not</strong> be used to calculate the lease liability on transition, the agency’s incremental borrowing rate will be used instead. If, after the date of initial application of AASB 16, the lease term is revised or the lease is modified, the specified rate may be used as the revised discount rate if it still reflects the implicit rate for the remainder of the lease term. The interest rate implicit in the lease (if specified) will be used as the discount rate for new leases that commence after AASB 16 becomes effective.</td>
</tr>
<tr>
<td><strong>Make good clauses</strong></td>
</tr>
<tr>
<td>Agencies should review make good clauses to assess whether any restoration provision should be recorded. The amount of any such provision is included in the cost of the right-of-use asset.</td>
</tr>
<tr>
<td><strong>Past lease payments and expenses</strong></td>
</tr>
<tr>
<td>If the agency elects to use the transition option in paragraph C8(b)(i) – see Transition section above, it will need to collect information about past lease payments, including payments made before lease commencement and variable rent increases that have occurred to date. The agency may exclude initial direct costs, as permitted by C10(d).</td>
</tr>
</tbody>
</table>
1.4.3  **AASB 1058 Income of Not-for-Profit Entities**

In December 2016, the AASB issued three key accounting standards relating to revenue recognition for not-for-profit (NFP) entities:

- **AASB 1058 Income of Not-for-Profit Entities** which clarifies and simplifies the income recognition requirements for financial years commencing on or after 1 January 2019. It also includes consequential amendments to other Australian Accounting Standards (refer Appendix D). There are significant amendments to:
  - AASB 16, where paragraph Aus25.1 is added to require NFP entities to the right-of-use assets obtained in ‘peppercorn leases’ at **fair value**; and
  - AASB 1004, where majority of income recognition requirements that have been superseded by AASB 1058 are deleted. AASB 1004 will continue to exist after AASB 1058 becomes effective, but it will only contain requirements for equity contributions and distributions, restructures of administrative arrangements, and liabilities of departments assumed by other entities.

- **AASB 2016-7 Amendments to Australian Accounting Standards – Deferral of AASB 15 for Not-for-profit Entities** which **extends the application date of AASB 15 to 1 January 2019 for not-for-profit entities** only to coincide with the application of AASB 1058; and

- **AASB 2016-8 Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities** which amends:
  - AASB 9 by including statutory receivables within its scope and inserting an Appendix C that provides guidance on statutory receivables; and
  - AASB 15 by adding scope paragraphs and inserting Appendix F that provides guidance on whether transactions of not-for-profit entities are within the scope of AASB 15, including identifying enforceable agreements and sufficiently specific performance obligations.

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**Not-for-profit agencies** are strongly advised to undertake a careful review of AASB 1058 and the amending standards listed above, noting the interactive relationship between AASB 1058 and AASB 15.

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1.4.3.1  **Transitional arrangements**

Treasury INTENDS TO MANDATE the partial retrospective approach in paragraph C3(b) of AASB 1058. Under this transition approach, agencies will not need to restate comparative figures in their 2019-20 financial statements. Instead agencies will recognise the cumulative effect of applying this standard as an adjustment to opening accumulated surplus at 1 July 2019. Additional disclosures in paragraph C7 are required when using this approach. Treasury will provide example disclosures in future model financial statements.

Treasury INTENDS TO PROHIBIT the election in paragraph C6 of applying the standard retrospectively only to contracts that are not completed contracts at 1 July 2019. A completed contract is one where the agency has already recognised all of the income in accordance with AASB 1004 prior to 1 July 2019. This means agencies will be required to assess any capital grants recognised as revenue/income prior to 1 July 2019 for which construction of the asset is not yet completed and recognise a liability reflecting the ‘unspent’ amount on transition, as per paragraph 16. (This does not apply to agencies (e.g. departments) who are equity appropriated for their capital expenses. See also AASB 15’s transition section (1.4.4.2) for the implications for grants that fall within the scope of AASB 15.)
Treasury INTENDS TO MANDATE the practical expedient in paragraph C8 allowing agencies to ignore remeasuring assets that were acquired for significantly less than fair value prior to 1 July 2019 (and originally measured at cost) at fair value on transition to AASB 1058.

For peppercorn leases entered into prior to 1 July 2019, upon initial application of AASB 16 and AASB 1058 agencies will need to determine the fair value of their right-of-use assets at 1 July 2019 and recognise the difference between the assets and any lease liabilities in opening accumulated surplus.

### 1.4.3.2 When does AASB 1058 apply to a transaction?

AASB 1058 applies to transactions of not-for-profit entities where the consideration to acquire an asset (including cash) is significantly less than fair value principally to enable the entity to further its objectives. Examples include:

- Cash and other assets received from grants, bequests or donations
- Receipts of appropriations by government departments
- Receipts of taxes and fines
- Assets acquired for nominal or low amounts

AASB 1058 also applies to volunteer services – see section 1.4.3.5 below.

The standard does not specify what constitutes “significantly” less than fair value, so judgement is required in this area. As guidance, Treasury suggest agencies consider 20 to 30 percent or more below fair value as being significant.

When a government agency is transferred/contributed an asset for significantly below fair value, usually the purpose is to enable the entity to further its objectives. Examples where this may not be the case include where transferor is forced to transfer at below fair value (e.g. distress sales) or where the discount is part of the transferor’s business strategy and is available to other similar entities (e.g. trade discounts, government discounts). Taxes and fines are paid to enable the government to further its objectives, even if they are involuntary transfers.

Arm’s length or commercial transactions typically do not involve a party providing to an agency asset/s for significantly less than fair value principally to enable the agency to further its objectives. Such transactions include for example leases at market rent, borrowings on commercial terms, or where the consideration is provided solely for performance obligations that fall within AASB 15. AASB 1058 does not apply to these transactions.

AASB 1058 applies to the difference between the asset received and any credit amounts recognised under other standards, called ‘related amounts’. This difference is recognised as income immediately, except for capital grants which are discussed in section 1.4.3.4 below.

### Which standard applies – AASB 1058 or AASB 15?

Agencies must consider both AASB 1058 and AASB 15 when accounting for grants and contributions from 1 July 2019 onwards.

AASB 1058 will apply to an entire grant, or a portion of the grant, that does not meet the enforceable and sufficiently specific performance obligations of AASB 15. In addition, if the output of the activities the agency is required to do under the grant agreement (e.g. a constructed physical asset, or the results of research) is retained by the agency for its own use, the transaction would also be accounted for under AASB 1058.
AASB 15 will apply where the grant agreement is enforceable and does contain sufficiently specific performance obligations that will result in the agency providing goods or services to other parties. Revenue under these grant agreements may qualify for deferral.

A grant may contain both enforceable performance obligations and a donation component to enable to the entity to further its objectives. In this case, the grant must be allocated between the performance obligations (AASB 15) and the donation component (AASB 1058).

The flowchart below shows the decision process for deciding whether AASB 1058, AASB 15, or both apply to a grant transaction.
Assets recognised under other standards are initially measured at **fair value** (or current replacement cost for inventories) as a result of amendments to those standards effected by AASB 1058 – refer to Appendix D of AASB 1058. Agencies then need to assess what related amounts need to be recognised under other standards, which will reduce the amount of revenue recognised under AASB 1058.

### 1.4.3.3 Changes to accounting for grants and contributions

AASB 1058, together with AASB 15, will bring significant changes to revenue recognition for grants and contributions.

Under AASB 1004 *Contributions*, revenue from non-reciprocal transfers (contributions) are recognised upfront, while reciprocal transfers are accounted for under other standards and may be deferred. A reciprocal transfer is one where the recipient of the funding directly gives approximately equal value to the grantor in exchange for the asset. This meant grants that were to be spent on providing benefits to third parties, such as the community, were classified as non-reciprocal transfers and therefore agencies recognised income upfront, even if the monies were to be spent over a number of years. This resulted in frequent mismatches between revenue and expenses.

Under AASB 1058, if a contract liability is recognised as a related amount, then income for that portion (which may be the entirety) of the grant is recognised in accordance with AASB 15 as the performance obligations are satisfied. AASB 15 applies to contracts with customers, and includes arrangements where the recipient entity provides benefits to third parties on behalf of the grantor/customer.

In summary, to defer recognition of grant income, agencies will no longer need to demonstrate they are directly giving approximately equal value back to the grantor. Agencies will instead need to demonstrate that the grant or funding agreement satisfy the ‘enforceable agreement’ and ‘sufficiently specific performance obligations’ criteria to be a contract with a customer under AASB 15. AASB 15’s revenue recognition rules will then apply to the grant and may result in deferral, refer to section 1.4.4 below.

The diagram below illustrates the changes in the conditions necessary for deferral of grant income.

![Diagram showing changes in conditions for deferral of grant income](image-url)
Guidance on determining whether there is an enforceable agreement and sufficiently specific performance obligations are in the AASB 15 section below.

**Grant expenses**

AASB 1058 and AASB 15 do not apply to grant expenses, and there will continue to be no specific AASB standards on grant expenses.

Currently, Treasury’s policies in FRR 3E apply the reciprocal vs non-reciprocal test to distinguish between grants and procurement, which determines the timing of expense recognition. This approach essentially mirrors revenue recognition under AASB 1004. However, AASB 1058/AASB 15 apply different principles to the reciprocal/non-reciprocal concept of AASB 1004.

During the 2018 calendar year, Treasury will review the principles underpinning FRR 3E and the need for amendments as a result of AASB 1058/AASB 15 replacing AASB 1004. This review will also address the recognition of grant expenses, and accounting for grant payments in advance of goods/services being delivered to the provider or third parties.

**1.4.3.4 Capital grants**

Usually grants that do not result in ‘related amounts’ under other accounting standards are recognised upfront. However, AASB 1058 requires deferral of income for capital grants received by the entity that meets the following three criteria:

1. The grant agreement requires the agency to acquire or construct the asset to identified specifications. The resulting asset must be a non-financial asset that is recognisable by the agency (e.g. under AASB 116 or AASB 138).

2. The agency is not required to transfer the asset to the grantor or other parties.

3. There is an enforceable agreement – this may be evidenced by a requirement to return funds if they were not used to acquire/construct an asset to the set specifications.

For capital grants meeting the above criteria, agencies would initially recognise an unearned revenue liability under AASB 1058 and recognise income when/as the entity satisfies its obligations under the transfer (e.g. when it acquires the asset or as it constructs the asset). This treatment is similar to a grant that falls within the scope of AASB 15. The constructed asset is recognised under other applicable standards such as AASB 116. Note that the amendments in AASB 1058 Appendix D about initial measurement at fair value would not apply to the acquired/constructed asset.

**1.4.3.5 Volunteer services**

Similar to under AASB 1004, government departments must continue to recognise volunteer services received as income where the fair value of the services can be measured reliably and the services would have been purchased if they had not been donated. The debit side of the transaction would be to an expense or an asset, as appropriate.

AASB 1058 also allows any NFP entity to recognise income for volunteer services whose fair value can be measured reliably, irrespective of whether the services would have been purchased if they had not been donated. However, Treasury’s policy is that agencies **shall not** recognise volunteer services that would not have been purchased if they had not been donated.
Therefore, agencies’ accounting for volunteer services will not change from current requirements as per AASB 1004 and the FRRs. AASB 1058 paragraph 27 encourages additional disclosures about volunteer services received, Treasury will consider the form of such disclosures in due course.

1.4.3.6 Peppercorn leases

AASB 1058 amends AASB 16 Leases so that the right-of-use assets arising from ‘peppercorn leases’ are measured at fair value (instead of at cost under AASB 16 paragraphs 23-24). This amendment applies to all lease with significantly below-market terms and conditions principally to enable the lessee entity to further its objectives. So the lease payments do not have to be a ‘peppercorn’ (e.g. $10 per year), as long as the AASB 1058 scope conditions are met.

Agencies should note that the fair value of the right-of-use asset is not necessarily the same as the fair value of the underlying asset. For example, the fair value of the right to use a building with a 40-year useful life for 5 years would be significantly less than the fair value of the underlying building. However for very long term leases, such as 99-year leases, the fair values can be expected to be similar. The difference between the right-of-use asset and the nominal liability amount is recognised as income under AASB 1058 upon commencement of the lease.
### 1.4.4  AASB 15 Revenue from Contracts with Customers

#### 1.4.4.1 Overview

**Application date**

The application date for AASB 15 is as follows.

Not-for-Profit entities: **1 January 2019** (refer to AASB 2016-7)

For-Profit entities: **1 January 2018** (refer to AASB 2015-8)

For-profit entities must therefore apply AASB 15 one year earlier than not-for-profit entities

**Summary of the standard**

AASB 15 sets out a comprehensive model for accounting for all revenue from contracts with customers, i.e. contracts involving the delivery of goods and/or services. AASB 15 will replace AASB 111 *Construction Contracts*, AASB 118 *Revenue* and a number of related interpretations. A contract will be outside the scope of AASB 15 if it falls within the scope of other specific standards such as leases (AASB 16), insurance contracts (AASB 4 / AASB 17) and financial instruments (AASB 9).

AASB 15 introduces a five-step revenue recognition model:

1. identify the contract;
2. identify the performance obligations;
3. determine the transaction price;
4. allocate the transaction price to the performance obligations; and
5. recognise revenue progressively as individual performance obligations are satisfied.

The model specifies that revenue should be recognised when an entity transfers control of goods/services to a customer, at the amount to which the entity expects to be entitled. Depending on specific contractual terms, the new model may result in a change in the timing and/or amount of revenue to be recognised. For example, some revenue may be recognised at a point in time (e.g. when control is transferred to the customer) and other revenue may be recognised over the term of the contract (e.g. when the entity satisfies its performance obligations progressively over a period of time).

**Potential impact**

The potential impact of AASB 15 on individual agencies will depend on the types of goods/services they provide, and whether/how the various concepts of AASB 15 (e.g. ‘contract’, ‘performance obligations’, etc.) would apply to existing arrangements. In particular, agencies receiving grants that have conditions attached are likely to be impacted by AASB 15 in conjunction with AASB 1058 – refer to section 1.4.4.3 below.

Agencies are **strongly advised** to undertake a careful review of AASB 15 to assess whether/how it may apply to their own transactions/arrangements. Agencies may need to implement new information gathering and/or system processes to enable compliance with the more comprehensive accounting and disclosure requirements of AASB 15.
1.4.4.2 Transitional arrangements

Treasury INTENDS TO MANDATE the partial retrospective approach in paragraph C3(b) of AASB 15. Under this transition approach, agencies will not need to restate comparative figures in their 2019-20 financial statements. Instead agencies will recognise the cumulative effect of applying this standard as an adjustment to opening accumulated surplus at 1 July 2019. Additional disclosures in paragraph C8 are required when using this approach, Treasury will provide example disclosures in future model financial statements.

Treasury INTENDS TO PROHIBIT the election in paragraph C7 of applying the standard retrospectively only to contracts that are not completed contracts at 1 July 2019. A completed contract includes one where the agency has already recognised all of the income in accordance with AASB 1004 prior to 1 July 2019. As a result, agencies will be required to assess any grants received prior to 1 July 2019 that fall within the scope of AASB 15 for any unsatisfied performance obligations and recognise a liability for those obligations on transition. This effectively allows agencies to ‘recycle’ revenue that was previously recognised under AASB 1004 and recognise them again when the agency satisfies the remaining performance obligations, and thus avoid being hit with potentially significant operating losses post-transition.

Treasury INTENDS TO MANDATE the practical expedient in paragraph C7A(b) of accounting for the aggregate effect of all contract modifications in accordance with paragraph C5(c) for all modifications that occur before the date of initial application (1 July 2019).

1.4.4.3 Deferral of grant income under AASB 15

Not-for-profit agencies will need to assess the implications for grants and contributions currently recognised as revenue immediately on acquiring control in accordance with AASB 1004. With AASB 15, the revenue may be deferred (initially recognised as a contract liability) to the extent that there is a contract to transfer goods or services to a customer, incorporating an enforceable agreement and sufficiently specific performance obligations. A single grant agreement may include both a contract with a customer under AASB 15 and a donation component, in which case the funds must be allocated to each component.

As discussed in section 1.4.3 above, this includes arrangements where agency provides goods/services to third party beneficiaries on behalf of the grantor. The agency will not be required to directly provide the goods/services back to the grantor, which is a currently a necessary condition for deferral under AASB 1004’s reciprocal vs non-reciprocal framework. Nevertheless, the agency must still be transferring goods/services to another party, i.e. it cannot retain the output solely for its own use.

The diagram below illustrates the key public-sector considerations when applying AASB 15’s five-step model.
The changes in accounting requirements mean agencies will need to analyse their funding agreements in a greater level of detail than previously required. Appendix F to AASB 15 and its accompanying illustrative examples provide guidance on when agreements would meet the prerequisites to be a ‘contract with a customer’ and fall within the scope of AASB 15. Agencies are strongly encouraged to read Appendix F (currently contained in AASB 2016-8) and the Illustrative Examples in AASB 1058 in detail to understand the relevant terms and features to look for in funding agreements in order to make this important assessment. Agencies must also evaluate agreements holistically after considering the combination of all relevant factors.

Below are some factors and indicators agencies may consider when evaluating their existing agreements and setting up new grant agreements. These are largely obtained from AASB 15 Appendix F and AASB 1058 Illustrative Examples.

**Transfer of goods or services to a customer**

“Customer” is defined in AASB 15 as a party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration. As noted above, the customer can direct the entity to provide the goods or services to third parties on the customer’s behalf.

- Grant arrangements where the agency retains the output of the activities (e.g. constructed asset, intellectual property from research) for its own use will be outside the scope of AASB 15 as it does not involve a transfer of goods or services to a customer. Agencies should apply AASB 1058 to these grants.
• In some cases, an agency may be party to a contract, but it has no obligation or control over the transfer of goods or services to the customer – rather, its obligations are limited to solely transfer (or ‘pass through’) cash between other relevant parties. Agencies should carefully examine such arrangements as the transaction (or components of a transaction) may not fall within the scope of AASB 15/AASB 1058 – instead, the agency may have a financial liability to be recognised under AASB 9 for monies to be passed on.

(N.B. For the avoidance of doubt, the previous dot point does not relate to monies appropriated to Departments to provide grant funding to Statutory Bodies under that department’s responsibility. Treasury are currently reviewing how AASB 15/AABS 1058 impacts the transfer of other grants between Government agencies (especially where the monies are passed through agencies using a ‘post-box’ arrangement. Guidance will be provided to agencies on these items by way of future updates.)

• Performance obligations do not include activities that an agency must undertake to fulfil a contract unless those activities transfer a good or service to a customer. For example, in a research grant, the research itself usually does not constitute a transfer of goods or services. Instead, the publication of research results or transfer of intellectual property to the customer are transfers of goods or services. (Paragraph F21)

Enforceable agreement

Form of agreement

• Usually a signed document such as a contract, a memorandum of understanding or a letter of intent forms the basis of an enforceable agreement. An agreement may be enforceable even if it is not legally binding and does not impose any refund obligations, as long as both parties have indicated their intent to rely upon it (Appendix F Example 1)

• Contractual agreements include those entered into at the direction of the grantor. For example, an agency may not have any say in whether or not it receives a contribution, but upon receiving the funds (with conditions attached), it has entered into an agreement.

• Enforcement mechanisms may arise from administrative arrangements or statutory provisions, such as a Ministerial Directive.

• Statements of intent to spend money or use assets in particular ways are in the nature of public policy statements; these do not by themselves create enforceable agreements. Examples here include budgets and service delivery statements.

Who can enforce the agreement?

• Generally, an agreement can be enforced by the customer/grantor, a party authorised to act on their behalf, and the judiciary (being the ‘separate party’ referred to in paragraph F11).

• Third party beneficiaries who receive the goods and service cannot enforce the agreement as they are not parties to the agreement. Those third parties may have certain rights under enacted legislation, however those rights exist independently from the agreement between the grantor and the recipient agency.

History of enforcement action is not relevant

• Enforceability is assessed on the grantor’s capacity and rights to enforce. It is not relevant that the grantor has historically not enforced similar agreements (e.g. not asking for refunds).
Refundability in event of non-performance

- The requirement to refund grant monies if they had not been spent on specified performance obligations is often an indicator of an enforceable agreement.

- However, refund of monies that are not spent within a specified time period is not, by itself, an indicator of an enforceable agreement.

- Instead of requesting a refund, the grantor may decide to reduce future funding to the agency, e.g. in multi-year grant agreements.
  - It is an indicator of enforceability if the grantor can reduce future funding to which the agency is presently entitled, effectively the grantor is choosing to settle the refund in net.
  - However, withholding of future funding to which the agency is not presently entitled does not demonstrate enforceability.

Other indicators of an enforceable agreement (F12)

- The parties to the agreement needing to agree on any alternative use of funds as a sign of an enforceable agreement.

- The grantor/customer has the right to take a financial interest in assets purchased or constructed by the recipient using the grant funding.

- An administrative process is established to enforce the agreement between the Commonwealth and the State of Queensland.

An agreement may be partially enforceable

- An agreement may be partially enforceable, for example, if only a portion of the grant is subject to refund if specified activities are not performed. In this case, the agency may recognise a contract liability under AASB 15 for the enforceable portion, and income under AASB 1058 for the non-enforceable portion.

Sufficiently specific performance obligations

Ability to measure progress towards satisfaction of performance obligations

- For performance obligations to be sufficiently specific, the agency must be able to determine when (or to what extent) the obligation is satisfied, in order to work out when and how to recognise revenue under AASB 15.

- To have sufficient specific performance obligations, the goods or services to be provided must be specified by or determinable in accordance with the agreement; they must not be at the discretion of the agency.

- Agencies must apply judgement, including taking into account any conditions specified in the contract, whether explicit or implicit, regarding the following aspects:
  - The nature or type of the goods/services
  - The cost or value of the goods/services
  - The quantity of the goods/services
The period over which the goods/services must be transferred

- The agreement may require an acquittal process for the recipient to demonstrate progress towards transferring the goods or services. Depending on the requirements of this process, it may provide evidence that the promise to transfer goods/services is sufficiently specific. (F26)

- Periodic progress reporting may also assist agencies with measuring its progress towards satisfying performance obligations. However, such reporting obligations are not considered separate performance obligations themselves. (Appendix F Example 2)

Example of performance obligations that are likely to be sufficiently specific:

- The quantity of goods/services to be provided is specified or can be determined, for example:
  - Provide free student accommodation for one student each year for 30 years (AASB 1058 Example 3C)
  - Provide a specified number of hours of counselling services each week for 12 months (AASB 1058 Example 6B)
  - Construction of two water wells for each $800 of donations received (AASB 1058 Example 7D)

- Agreement is to provide specified services over a specified period, for example:
  - Undertake research on a specific topic over 3 years and publish research data as it is obtained (Appendix F Example 4A). Note in this case the good or service transferred to the customer is the publication of research data, not the research itself.

Examples of contractual terms that are unlikely to be sufficiently specific:

- An obligation to ‘spend money’ alone does not constitute a performance obligation. AASB 15 is about the goods or services the agency is required to transfer to a customer in return for the funding received.

- Obligations would not be sufficiently specific if the agency would be unable to measure its progress towards satisfying the obligations. This is usually the case when the goods/services to be provided are unspecified, unquantifiable, or is at the discretion of the agency. For example:
  - Undertake education programs over 3 years to increase the literacy of students in a specific rural area (AASB 1058 Example 8A)
  - Provide free student accommodation for one student each year, for as long as the university operates (AASB 1058 Example 3B)
  - Undertake research on a specific topic and publish results when appropriate, as determined by the research entity (Appendix F Example 5A).

- A requirement that the entity must spend the funds to perform activities in accordance with its charter or stated objectives is unlikely be sufficiently specific, even if the entity has a single purpose charter or a single objective. (AASB 1058 Example 6A, AASB 15 paragraph F25)
1.4.4.4 Contract modifications

AASB 15 has new requirements around contract modifications, with three different accounting treatments possible depending on the circumstances of the modification. This is summarised in the flowchart diagram below.

**Contract modifications under AASB 15**

- **Addition of distinct goods or services AND price increase reflects the stand-alone prices of the new goods or services**: Yes → Create a separate contract for the additional goods or services and keep the existing contract (Paragraph 20)
  - No → Remaining goods or services are distinct from goods or services already transferred up to the date of modification
    - Yes → Terminate the existing contract and create a new contract based on the remaining goods or services (Paragraph 21(a))
    - No → Revise the existing contract by reallocating the total transaction price to the performance obligations and adjust revenue recognised (Paragraph 21(b))

Note that on transition, agencies are to apply the practical expedient in paragraph C7A(b) and would not retrospectively account for contract modifications that happened prior to transition. Nevertheless, agencies should familiarise with the new requirements for application to changes to revenue contracts, such as grant or funding agreements, after 1 July 2019.

1.4.4.5 New principal vs agent rules

Principal vs agent rules determine whether certain transactions are recognised in an entity's financial statements. The current distinction set out in AASB 118 is that an entity is acting as a principal when it has exposure to the significant risks and rewards associated with the sale of goods or the rendering of services, and is acting as an agent when it does not have such exposure.

The distinction is changed in AASB 15 to whether the entity ‘controls’ a good or service before transferring that good or service to the customer. Control in the context of goods and services is discussed in paragraph 33. Indicators that an entity is acting as principal include (B37):

- The entity is primarily responsible for fulfilling the promise to provide the good or service.
• The entity has inventory risk before transferring the good or service to the customer.
• The entity has discretion in establishing the price for the good or service.

The above indicators in AASB 15 are largely consistent with AASB 118 Illustrative Example 21, except that the entity being exposed to credit risk is no longer listed as an indicator. Agencies will need to reassess transactions where the agency was previously determined to be acting as principal solely because of credit risk in the context of revenue/expenses from the sale of goods or services - these transactions may need to be reclassified as agent transactions under AASB 15 (having regard to the particular circumstances of the arrangement). Agencies with transactions where it is acting as an agent are directed to paragraphs B34-B38 (including uncompiled amendments in AASB 2016-3) and reassess transactions where necessary.

1.4.4.6 Public sector licences

In December 2017, the AASB issued an exposure draft ED 283 on accounting for licence revenue by not-for-profit public sector licensors. This exposure draft intends to include in AASB 15’s scope all licences issued by NFP public sector entities, including statutory licences and non-intellectual property licences, and provide guidance on their accounting treatment. Examples include driver’s licences, gaming licences, blue cards, fishing licences, etc.

Treasury will communicate policy decisions and guidance material on this matter in a subsequent FRR update, once the AASB issues the amending Standard.

1.4.4.7 Disclosures

AASB 15 contains many new disclosures and will significantly increase the volume of disclosures regarding revenue compared to existing standards. There will also be extended disclosures on significant judgements made by the entity in applying various aspects of the standard. Agencies are encouraged to familiarise themselves with the disclosure requirements in paragraphs 110 to 129 and consider whether changes to existing systems are needed to capture the necessary information.
1.4.5 AASB 1059 Service Concession Arrangements: Grantors

AASB 1059 Service Concession Arrangements: Grantors will be effective for reporting period beginning on or after 1 January 2019. This standard addresses accounting by public sector grantors in Service Concession Arrangements, also known as public-private partnerships (PPPs).

Agencies should review their existing PPP arrangements and any forthcoming/proposed PPPs to identify whether they will be impacted by AASB 1059, and assess the potential financial statement impacts.

1.4.5.1 Transitional arrangements

Under AASB 1059, agencies will be required to adjust their comparative figures in their 2019-20 financial statements and will require agencies to determine an opening balance for each service concession arrangement at the beginning of the comparative period (1 July 2018).

However, Treasury INTENDS TO MANDATE the ‘partial retrospective’ option in paragraph C3(b) of AASB 1059 allowing agencies to:

- Recognise service concession assets at their current replacement cost at 1 July 2018;
- Recognise any financial liability in accordance with AASB 1059 (being the current replacement cost adjusted for any consideration received/paid between the grantor and operator);
- Recognise any unearned revenue liability by adjusting the asset’s current replacement cost by the remaining period of the service concession arrangement divided by the remaining economic life of the asset – see Example 10 in AASB 1059; and
- Recognise the net difference between assets and liabilities in opening accumulated surplus.

1.4.5.2 Existing pronouncements

Before AASB 1059, there were no authoritative accounting guidance for grantors for service concession arrangements. Related pronouncements include:

- Interpretation 12 Service Concession Arrangements – This interpretation only addresses accounting by operators and does not address accounting by grantors.
- Interpretation 129 Service Concession Arrangements: Disclosures – This interpretation addresses disclosure requirements for service concession arrangements, but does not provide guidance on accounting (recognition and measurement) for such arrangements.
- IPSAS 32 Service Concession Arrangements: Grantor – Issued by the International Public Sector Accounting Standards Board.

Treasury’s position (in FRR 5D) is that agencies are not to apply IPSAS 32 or mirror accounting of Interpretation 12 without first undertaking a thorough review of the circumstances and substance of the arrangement. Agencies are required to make the disclosures required by Interpretation 129. In the absence of specific accounting pronouncements, agencies with service concession arrangements have generally followed guidance in Appendix 1 of FRR 5D and as a result:

- have not recognised ‘Economic infrastructure arrangements’ on the balance sheet, and
- recognised ‘Social infrastructure arrangements’ as leases in accordance with AASB 117.
1.4.5.3 New requirements

Although AASB 1059 is broadly consistent with IPSAS 32, there are a few differences which are outlined in the standard under the section “Comparison with international pronouncements”.

Scope

AASB 1059 defines service concession arrangements and uses a control approach to assess which arrangements are within scope and are therefore recognised on the balance sheet.

Service concession arrangements

A service concession arrangement is defined as a contract between a grantor and an operator in which:

- the operator has the right of access to the service concession asset (or assets) to provide public services on behalf of the grantor for a specified period of time;
- the operator is responsible for at least some of the management of the public services provided through the asset and does not act merely as an agent on behalf of the grantor; and
- the operator is compensated for its services over the period of the service concession arrangement.

For an arrangement to be a service concession arrangement under AASB 1059, the operator must be providing public services on behalf of the grantor and be managing at least some of those public services under its own discretion, rather than at the direction of the grantor. It is important to correctly apply this concept in certain build and maintain arrangements where the operator constructs public infrastructure and provides maintenance services for the duration of the arrangement. Agencies need to assess what are the public services provided by the asset and the extent to which the operator’s services contribute to the public services provided by the asset. The hypothetical examples below illustrate the key principles specified in paragraph B10 of AASB 1059:

<table>
<thead>
<tr>
<th>Example</th>
<th>Assessment</th>
<th>Conclusion</th>
</tr>
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<tbody>
<tr>
<td>Operator constructs school buildings and provides, under its own discretion, facilities management, cleaning and security services.</td>
<td>Public services provided by the school are primarily education services. The operator’s maintenance services do not represent a significant component of the public services provided by the school. Instead the maintenance services represent a service outsourcing arrangement to enable the grantor to provide public services (education) through the school.</td>
<td>Arrangement is unlikely to be a service concession arrangement under AASB 1059. However, the agency would instead account for this arrangement under other applicable accounting standards, such as AASB 116.</td>
</tr>
<tr>
<td>Operator constructs hospital building and provides, under its own discretion, facilities management, cleaning and security services, along with hospital staff scheduling services.</td>
<td>Public services provided by the hospital are primarily health care services. The operator’s scheduling of hospital staff (who are employed by the government) is likely a sufficient indicator that the operator is managing at least some of the public services provided by the hospital.</td>
<td>Arrangement is likely a service concession arrangement</td>
</tr>
</tbody>
</table>
Example | Assessment | Conclusion
--- | --- | ---
Operator builds a toll road, collects tolls, and provides road maintenance services under its own discretion. | A road provides public services (i.e. transport) largely by itself as long as it is properly maintained. Therefore, the operator’s maintenance services contribute significantly to the public services provided by the road. | Arrangement is likely a service concession arrangement

**Control**

The public sector grantor controls the service concession asset if and only if:

- a) the grantor controls or regulates
  - i. what services the operator must provide with the asset,
  - ii. to whom it must provide them, and
  - iii. at what price; and

- b) the grantor controls - through ownership, beneficial entitlement or otherwise – any significant residual interest in the asset at the end of the term of the arrangement.

The grantor can also demonstrate control of the services to be provided with the asset, to whom and/or at what price where those aspects are regulated by a third party regulator. In this case, the services/recipient/price is considered to be set implicitly by the grantor. The contract between the grantor and the operator need not specifically refer to the regulator or regulation.

Agencies should note if the arrangement is not a service concession arrangement or the agency does not control the asset under AASB 1059, the agency must consider if other accounting standards apply to the arrangement (e.g. AASB 116, AASB 16 or AASB 9).

**Accounting for service concession arrangements**

**Service concession asset**

Where the arrangement is a service concession arrangement and the grantor controls the service concession asset, the asset is recognised on balance sheet at current replacement cost. An existing asset of the agency that meets these conditions is to be reclassified as a service concession asset, and its carrying amount is adjusted to current replacement cost as a revaluation.

Subsequently, the asset is depreciated in accordance with AASB 116. If the asset’s class is required to be measured at fair value by NCAP 1 (most likely), the valuation must be based on current replacement cost.

**Liability**

Agencies will also recognise a liability at the same time as recognising the service concession asset. The liability is initially measured at the same amount as the asset, adjusted for any other consideration exchanged between the grantor and the operator.

The nature of the liability depends on how the operator is compensated. In a service concession arrangement, the grantor usually compensates the operator by any combination of:

- making payments to the operator,
- granting the operator the right to charge third party users for use of the asset (e.g. a toll road),
• granting the operator access to another revenue-generating asset for the operator’s use (e.g. a private wing of a hospital)

Where the agency is obliged to make future payments to the operator, it recognises a financial liability. The future payments must first be allocated to payments relating to the liability (capital component) and payments for services to be provided by the operator (operating component). Agencies must then calculate a discount rate that discounts the future ‘capital’ payments to the pre-determined liability amount. Subsequently the financial liability is measured in accordance with AASB 9.

Where the agency grants the operator a right to charge third party users or to access another revenue-generating asset, it recognises an unearned revenue liability. Revenue is recognised throughout the term of the arrangement according to the economic substance of the arrangement. In practice, a straight-line method is often appropriate.

If the agency both makes future payments and grants a right to the operator, it would need to calculate the financial liability portion first by discounting future payments using the contractually specified interest rate or otherwise a prevailing market rate. The remaining portion of the liability is recognised as unearned revenue.