Scope: This bi‑annual newsletter outlines areas of particular importance in public sector financial reporting. Please distribute to both budget and financial reporting areas of Victorian public sector entities.

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Overview

As we are half way through the 2015‑16 reporting period, the focus of this newsletter is to provide information and updates to Victorian Public Sector (VPS) entities for the preparation of their 2015‑16 annual reports. The 2015‑16 reporting year section of this newsletter outlines the key proposed changes relating to the *2015‑16 Model Report for Victorian Government Departments*, together with an update of the financial reporting directions that were recently revised and those currently under review. With the withdrawal of the 2004 long service leave (LSL) model from the Department of Treasury and Finance (DTF) website on 30 June 2016, departments and entities should reassess the appropriateness of their LSL model and consider any transitional adjustments required.

Following the release of AASB 124 *Related Party Disclosures,* the AASB 124 implementation project has been progressing which will have significant disclosure impact for all not‑for‑profit (NFP) entities from 1 July 2016.

Looking forward, there will be a number of accounting standards and Australian Accounting Standards Board (AASB) projects that may have potential implications for entities across the public sector. The effective date of AASB 15 *Revenue from Contracts with Customers* has been deferred to 1 January 2018. The AASB has also been deliberating on the feedback received on the exposure drafts for income of NFP entities and service concession arrangements.

2015‑16 reporting year

Alert

AASB 124 Related Party Disclosures project

The AASB recently extended the scope of AASB 124 to include NFP public sector entities. This revised reporting requirement will apply to departments and NFP agencies from **1 July 2016 (i.e. from the 2016‑17 financial year)**, with no comparatives required for the first period to which this change applies.

DTF has undertaken a preliminary assessment of AASB 124 and consulted with other jurisdictions with a view to forming a consistent framework for the application of AASB 124 across public sector entities. A working group comprising of departmental representatives has been formed to agree on the proposed parameters of the Standard.

An information sheet has been developed to assist with:

* identification of key management personnel (KMP);
* remuneration disclosures for KMP; and
* related party transaction disclosure.

DTF has also developed guidance and a checklist, which have been circulated together with the information sheet to departments for feedback, to collect related party transactions as required under AASB 124.

DTF is currently in the consultation with the Victorian Auditor‑General’s Office (VAGO) on the proposed assessment and the data collection process. Once agreed, DTF will engage with the Minister for Finance and the broader Cabinet to proceed with the implementation phase of the project.

Bond rates used for employee entitlement assessment by for‑profit entities

AASB 119 *Employee Benefits* generally requires long‑term employee benefit liabilities to be discounted using market yields on high quality corporate bonds at the end of the reporting period. Where there is no ‘deep market’ for such bonds, AASB 119 requires the market yields on government bonds to be used to discount those liabilities.

Recently, the Group of 100 commissioned Milliman Australia to answer whether there was a deep market for high quality corporate bonds in Australia. The report concluded the Australian high corporate bond market is sufficiently deep to satisfy the requirements in AASB 119.

While some accounting firms have publicly supported the Group of 100 and Milliman’s findings, there are also opposing views in the market and some participants do not believe that the Milliman report contains compelling evidence to support a change from the use of government bond rates.

The Australian Securities and Investments Commission has not publicly commented on the report. In addition, the AASB has not publicly stated whether they concur with Milliman’s findings.

It should be noted that NFP public sector entities are still required to use government bond rates for the discounting of employee benefit liabilities and will be unaffected by this issue.

Whether Australia has a deep market of high quality corporate bonds is largely subjective and a matter of judgment. DTF is continuing to monitor emerging practice and consultation with other jurisdictions. DTF will advise the affected for‑profit entities of any change as soon as practicable.

Long service leave model transition

DTF currently provides two alternative models (the 2004 and 2008 models) to assist VPS entities to calculate their LSL liability in accordance with the requirements of AASB 119. While the use of DTF models is recommended, it is not mandatory.

The 2004 LSL model will be withdrawn from the DTF website on **30 June 2016** and its maintenance will no longer be supported by DTF. Departments and entities will need to assess the validity of their current models’ underlying assumptions based on their current circumstances (employee profiles, leave utilisation patterns, etc.) to determine if the 2004 LSL model continues to reflect the substance of the entity’s employee profile and leave utilisation pattern as per the requirements of AASB 119. If the assessment suggests that the assumptions are inconsistent with the utilisation prospect of their employees’ entitled LSL, departments and entities should consider transitioning to an appropriate model and advise their relevant DTF or portfolio departmental contact of the expected transitional impact and any funding implication.

There are three major differences between the two DTF models as follows:

* **leave utilisation patterns:** the 2008 model assumes a more prolonged leave utilisation pattern;
* **discount rates:** the 2008 model uses a single weighted average discount rate, whereas the 2004 model uses rates based on bond rates with different maturity periods from one year to 12 years. The 2008 model adopts a simplified approach permitted by AASB 119; and
* **employee retention rates:** the 2008 model uses an average retention rate for all employees, whereas the 2004 model uses different retention rates for employees with different years of service.

Depending on an entity’s employee profile, there may be a modest increase in the LSL liability on transition to the 2008 LSL model for departments and entities applying the standard wage indexation rate published by DTF. However, there may be a larger impact for departments and entities applying a higher wage indexation rate or having a significant population with long years of service due to the higher net rate of the wage indexation and discounting. Therefore, these departments and entities will expect a higher increase in LSL provision and related expenses, requiring management of leave balances and consideration of funding implications.

2015‑16 Model Report for Victorian Government Departments (2015‑16 Model Report)

DTF anticipates a release of the 2015‑16 Model Report by mid‑April 2016.

The key changes compared with the 2014‑15 Model Report include:

* new illustrative disclosures for information communication technology (ICT) expenditure and revised illustrative disclosures for government advertising expenditure due to revised reporting requirements in FRD 22G *Standard Disclosures in the Report of Operations* (refer in further detail below);
* new illustrative disclosure of completed capital projects based on the Public Accounts and Estimates Committee recommendation;
* enhanced illustrative disclosure of the performance reporting section required under FRDs in the Report of Operations; and
* minor improvements on disclosures based on VAGO’s recommendations.

A list of the significant changes will be included in the Summary of Changes accompanying the 2015‑16 Model Report.

Financial Report Directions (FRDs) and guidance notes

Since the last newsletter, FRD 22F *Standard Disclosures in the Report of Operations* has been revised to:

* incorporate the new disclosure requirement for ICT expenditure; and
* reduce the disclosure threshold for government advertising expenditure from $150 000 to $100 000.

The revised FRD 22G is applicable for the 2015‑16 reporting period.

DTF is also reviewing the whole suite of FRDs for general improvements, including updates of references and removal of information duplicated in the Model Report. The revised suite of FRDs will apply for the 2015‑16 reporting period with no significant changes expected from the revisions.

2015‑16 financial reporting legislation

Financial Management Act

The *Financial Management Act 1994* (FMA) continues to be the principal legislation governing VPS financial reporting for 2015‑16.

Standing Directions

The Minister for Finance has committed to revise the Standing Directions issued under the FMA. The reform will help modernise Victoria’s public financial management through strengthened accountability, planning and decision‑making, and a stronger flow of information between departments, agencies and government.

DTF consulted across the VPS on draft revised Directions in September and October 2015. Subject to the Minister’s approval, the revised Directions are scheduled for publication in February 2016, with an effective date of 1 July 2016 (subject to some transitional arrangements).

Release of the new ABS manual

The Australian Bureau of Statistics (ABS) has released a new manual, *Australian System of Government Finance Statistics: Concepts, Sources and Methods 2015* on 23 December 2015. The new manual incorporates the revisions of the international standard for the compilation of the national accounts statistics as outlined in the International Monetary Fund’s Government Finance Statistics Manual. It will be implemented from the September quarter of 2017.

DTF centrally submits quarterly and annual data to the ABS on behalf of the State and general government sector. The data is based on the existing actual and estimate data feeds in SRIMS.

DTF is currently in the process of assessing the impact of the changes and will consult departments where appropriate. The Consolidated Reporting and Analysis (CRA) team will communicate the assessment outcome to departments and any interim enquiries can be directed to Bop Leas (contact no.: 9651 1622/email: bop.leas@dtf.vic.gov.au).

Other guidance

Superannuation Guarantee Levy

The Superannuation Guarantee Levy (SGL) schedule has been updated in accordance with the *Minerals Resource Rent Tax Repeal and Other Measures Act* *2014* (the Act) passed in September 2014. Based on the Act, the future SGL rates will remain at 9.5 per cent until 30 June 2021, before making yearly increments of 0.5 per cent from 2021 to 2025.

Departments and entities should use the new SGL schedule when estimating and measuring employee benefit liabilities and expenses for financial reporting and future budget estimates. The table below outlines the new SGL rates for the financial years beginning from 1 July 2015 to 1 July 2025, with the previous SGL schedule included for comparison.

|  |  |  |
| --- | --- | --- |
| Date | New SGL schedule | Old SGL schedule |
| **(per cent)** |
| 1 July 2015 | 9.50 | 10.00 |
| 1 July 2016 | 9.50 | 10.50 |
| 1 July 2017 | 9.50 | 11.00 |
| 1 July 2018 | 9.50 | 11.50 |
| 1 July 2019 | 9.50 | 12.00 |
| 1 July 2020 | 9.50 | 12.00 |
| 1 July 2021 | 10.00 | 12.00 |
| 1 July 2022 | 10.50 | 12.00 |
| 1 July 2023 | 11.00 | 12.00 |
| 1 July 2024 | 11.50 | 12.00 |
| 1 July 2025 | 12.00 | 12.00 |

Wage inflation and discount rates

The wage inflation and discount rates are published quarterly (monthly in the last quarter of each financial year), to assist VPS entities in ascertaining their financial position for the year‑end. The rates for 31 December 2015 were published on the DTF website on 4 January 2016. The rates for 31 March 2016 will be published at the beginning of April.

There have been fluctuations in the annual effective discount rates published by DTF in the recent two years as illustrated in the graph below. Entities are reminded to **remeasure** the provisions to reflect the impact of the updated wage inflation rate and discount rates in preparation of the upcoming State’s *Mid‑Year Financial Report*. Keeping other factors constant, a lower discount rate will result in an increase in employee entitlement provision and the related expenses, and vice versa.



2015‑16 key financial publication dates for the State of Victoria

The following table shows the indicative key publication tabling dates for the State’s upcoming financial publications.

| Reporting year | Publication | Anticipated tabling dates – actual dates to be confirmed |
| --- | --- | --- |
| 2015‑16 | *Mid‑Year Financial Report* | Legislative due date is 15 March 2016. |
| 2016‑17 | Budget papers | Expected date is 3 May 2016 (first Tuesday of May). |
| 2015‑16 | Annual Financial Report | Anticipated for the end of September 2016. Legislated due date is 15 October 2016. |
| 2015‑16 | Department and entity reporting | Expected to be tabled progressively on or before the last sitting day in September 2016. |

Looking forward

Key AASB Standards issued but not effective for 2015‑16

Deferral of AASB 15 Revenue from Contracts with Customers

The AASB recently issued [AASB 2015‑8](http://www.aasb.gov.au/ADMIN/file/content105/c9/AASB2015-8_10-15.pdf) *Amendments to Australian Accounting Standards – Effective Date of AASB 15*. This Standard defers the mandatory effective date of AASB 15 from 1 January 2017 to 1 January 2018.

AASB’s major domestic projects

Income from transactions of not‑for‑profit entities

Following the issuance of Exposure Draft (ED) 260 *Income of Not‑for‑Profit Entities* in April 2015*,* the AASB has been considering the feedback from the comment letters received. For an overview of the major implications of the ED, please refer to *Accounting policy update, Newsletter – Edition No. 28*.

The predominant concerns from constituents’ feedback relate to the ‘sufficiently specific’ and ‘enforceability’ characteristics, as income from grants can only be deferred upon the fulfilment of both characteristics.

The AASB has tentatively decided:

* to retain the ‘sufficiently specific’ principle in order to determine when a performance obligation exists for the deferral of revenue recognition;
* to further explore the link between ‘sufficiently specific’ and ‘distinct’ as used in AASB 15 and in the context of an explicit and/or implied promise. AASB 15 requires that, to qualify as a performance obligation, the goods or services in an entity’s promise to transfer goods or services must be ‘distinct’ and therefore that promise is separately identifiable from other promises in the contract;
* that a transfer to a NFP entity that has a single purpose charter (e.g. counselling service) would not automatically result in such a promise meeting the ‘sufficiently specific’ criterion. The transfer must also have an attached condition of when the service should be provided; and
* to retain the notion that a transferor’s stipulation to use the transferred funds over a particular time period, without any other conditions, does not meet the ‘sufficiently specific’ criterion as time is not a good or service.

The AASB will continue its redeliberation of when an agreement is ‘enforceable’ at the next Board meeting in February 2016.

Service concession arrangements: grantor accounting

Following the issue of ED 261 *Service Concession Arrangements: Grantor* in May 2015 (please refer to *Accounting policy update, Newsletter – Edition No. 28* for details), the AASB has initiated field testing of the requirements of ED 261.

The objective of the field test is to gain a deeper understanding of the issues and challenges in accounting for service concession arrangements to assist the AASB in finalising the service concession arrangements project.

Discussions have commenced with field test participants to discuss the scope of issues to be explored in the field test.

AASB staff anticipate that the field test may result in the inclusion of additional guidance and complex examples to address areas of concerns identified in the field test. It is expected that the findings and guidance will be presented for Board consideration in June 2016.

Depreciated replacement cost as a measure of value in use

Currently AASB 136 *Impairment of Assets* adopts the concept ofdepreciated replacement cost (DRC) while AASB 13 *Fair Value Measurement* adopts the concept of current replacement cost (CRC). AASB 136 requires NFP entities to use DRC as a measure of value in use of an asset not held primarily to generate net cash inflows and where the entity would, if deprived of the asset, replace its remaining future economic benefits. In comparison, the CRC approach under AASB 13 reflects the amount that would be required currently to replace the service capacity of an asset.

The AASB noted the two concepts are expected to result in similar outcomes, and in practice valuers treat them interchangeably for specialised assets. To eliminate any potential confusion, the AASB issued ED 269 *Recoverable Amount of Non‑cash‑generating Specialised Assets of Not‑for‑Profit Entities*, proposing to amend AASB 136 to remove the references to using DRC as a measure of value in use for NFP entities. The ED also proposes to clarify that many assets of NFP entities that are not held primarily to generate net cash inflows are typically specialised assets. As these assets are held for continuing use of their service capacity and rarely sold, their cost of disposal is typically negligible, and their recoverable amount is expected to be materially the same as the fair value determined under AASB 13.

The AASB is planning to issue the amending standard in Q1 2016. NFP entities that revalue their primarily non‑cash‑generating specialised assets to fair value regularly would automatically meet the impairment requirements under AASB 136.

Major international project

Leases

This is an International Accounting Standards Board (IASB) and Financial Accounting Standard Board joint project to develop a new standard for both lessors and lessees, which would supersede the current requirements under IAS 17 *Leases*. The AASB issued ED 242 *Leases* in 2013, which incorporated the IASB’s corresponding ED. For an analysis of the major implications of the ED, please refer to *Accounting policy update, Newsletter – Edition No. 28*.

The new lessee accounting model in ED 242 removes the finance/operating lease distinction by introducing a single model of recognising ‘right of use’ assets and lease liabilities.

However, Government Finance Statistics (GFS) distinguish leases between operating and finance leases based on whether there is a transfer of risks incidental to ownership of the underlying leased asset. Therefore, the new lessee model would introduce differences between GFS and Australian Accounting Standards in the recognition, measurement and classification of leases. The differences would need to be disclosed in a reconciliation note to the financial statements with an explanation of the difference as required by AASB 1049 *Whole of Government and General Sector Financial Reporting*. Therefore, entities may need to keep a set of records separate from the accounting record for the data feed to DTF to meet the whole of government GFS disclosure requirements. DTF will provide further advice on this in due course.

The AASB is planning to issue the new leasing standard in Q1 2016. The tentative effective date of the new standard is 1 January 2019.

Application of materiality to financial statements

The IASB carried out research on the term ‘materiality’ as part of its Disclosure Initiative project. The objective is to help preparers, auditors and regulators to use judgement when applying the concept of materiality. The IASB issued ED/2015/8 IFRS Practice Statement: *Application of Materiality to Financial Statements* in October 2015, seeking comments until February 2016.

Information is material if omitting or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. The draft Practice Statement provides guidance in the following three main areas:

General characteristics of materiality

The draft Practice Statement discusses the characteristics of materiality, including:

* the pervasiveness of the materiality concept to the preparation of financial statements;
* management’s consideration of both the entity’s specific circumstances and the intended uses by the financial statement users;
* management’s consideration of the characteristics of primary users of financial statements, including their likely interests and decision types;
* roles of both qualitative and quantitative factors in applying materiality; and
* the assessment of materiality on both an individual and a collective basis.

Making judgements about materiality when deciding how to present and disclose information

The draft Practice Statement provides guidance to help management make judgements about materiality when deciding how to present and disclose information in the financial statements:

* the concept of materiality should be applied in the light of the objective of the financial statements;
* providing immaterial information may obscure material information and consequently make financial statements less understandable;
* management should assess whether the information that would be ‘lost’ through aggregation is material in determining the level of aggregation; and
* there will be different conclusions regarding whether information is material in the different context of the primary financial statements, the notes to the financial statements, the complete set of financial statements and interim reports, due to their different roles and objectives.

Assessing whether omissions and misstatements of information are material

Omissions and other misstatements of information are material if, individually or collectively, they could reasonably be expected to influence decisions of the primary users of the financial statements.

The draft Practice Statement includes guidance on:

* assessing whether misstatements are material;
* current period misstatements versus prior period misstatements; and
* misstatements made intentionally to mislead.

The AASB has incorporated IASB ED/2015/8 into AASB ED 271 *IFRS Practice Statement: Application of Materiality to Financial Statements* and tentatively decided to issue it as a non‑mandatory AASB Practice Statement when finalised.

How to contact us

AccPol mail box

When directing accounting policy enquiries to DTF at accpol@dtf.vic.gov.au, **Departments** are requested to support their questions with the facts and with clear referencing to Accounting Standards, FRDs and other authoritative pronouncements related to their queries.

**Other entities** are requested to contact their portfolio department in the first instance to resolve any accounting policy issues.

Useful websites

**AASB** – [www.aasb.com.au](http://www.aasb.com.au) for information on AASB pronouncements, discussion papers and ED publications.

**International Public Sector Accounting Standards Board** (IPSASB) – [www.ifac.org/public‑sector](http://www.ifac.org/public-sector)/ for information on IPSASB and IPSASB pronouncements.

DTF website

**The DTF website (for all internet users)** – [www.dtf.vic.gov.au](http://www.dtf.vic.gov.au/Government-Financial-Management/Financial-reporting-policy), covers FRDs and guidance, the Model Report, accounting policy updates, wage inflation and discount rates. From the menu on the top of the home page, users should select Government Financial Management, then Financial Reporting Policy.

**VPS users** should contact their portfolio department in the first instance for the login details to access the information relating to the 2008 Long Service Leave Model, the Valuer‑General building and land indices.

For assistance with technical difficulties using the DTF website, e.g. broken links, please contact the DTF web team via email at dtfweb@dtf.vic.gov.au.

About the Accounting Policy Update

Accounting Policy Update is published by the Accounting Policy team of DTF twice a year. The aim of the newsletter is to highlight changes in financial reporting requirements affecting public sector entities, outlining any financial reporting related policy decisions reached by DTF and to inform readers of other developments that are under consideration by the AASB.

**Disclaimer:** No responsibility is taken for any action(s) taken on the basis of information contained in this newsletter nor for any errors or omissions in that information.

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