Accounting policy update

Newsletter – Edition No. 31, December 2016

#### 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

Two significant changes are being introduced for the current year – the streamlining of departmental annual financial reports and the disclosure of related party transactions for all not‑for‑profit public sector entities as required by the revised AASB 124 *Related Party Disclosures*. Each of these changes will be reflected in the upcoming *2016‑17* *Model Report for Victorian Government Departments.*

As we are halfway through the 2016‑17 financial year, all Victorian public sector (VPS) entities are reminded to assess and ensure their non‑financial assets are reflected at fair value annually, and consider whether there is a need to revalue their non‑financial assets, taking all relevant factors into consideration, including the recently released Valuer‑General Victoria (VGV) indices.

The wage inflation rate for 31 December 2016 is expected to decrease slightly due to the decline in the Victorian wage price index forecast, and this is expected to have a small downwards impact on the provision for employee benefits.

Although there are no other new or revised Australian Accounting Standards (AAS) that are applicable for the 2016‑17 financial year, other than the revision to AASB 124, there are a few new standards on the horizon which may have a more significant impact on entities across the public sector in the near future and may require changes to systems for data collection purposes. They include AASB 9 *Financial Instruments*, AASB 15 *Revenue from Contracts with Customers*, AASB 10XX *Income for Not‑for‑Profit Entities*,
AASB 16 *Leases* and ED 261 *Service Concession Arrangements*. While the core principles and potential impacts have been elaborated in previous newsletters, this newsletter provides information on the most recent updates on AASB 15 and
AASB 10XX and a recap of the rest of the new standards.

# 2016‑17 reporting year

## Major updates/reminders

### 2016‑17 Model Report for Victorian Government Departments

Following the successful streamlining of the *2015‑16 Financial Report* for the State of Victoria*,* the Department of Treasury and Finance (DTF) has commenced the project of streamlining the 2016‑17 *Model Report for Victorian Government Departments* (Model Report).

Compliance with the Model Report is mandatory for departments and provides the framework for the preparation of financial reports. Other public sector agencies are encouraged to follow it for consistency in reporting. The 2016‑17 Model Report is expected to be released in April/May 2017. The Model Report will include a set of streamlined financial statements, revised remuneration disclosure for executives and additional disclosure on related parties to comply with revised AASB 124 requirements.

The objectives of streamlining are to:

* present the existing financial information in a structure to better communicate key messages;
* incorporate accounting policies and key judgements into the relevant notes to the financial statements;
* rewrite, reorder and relabel the notes to the financial statements to provide greater insight into operations and outcomes; and
* remove duplication and irrelevant disclosures.

While presented in a streamlined format, the financial statements will continue to fully comply with the relevant legislative requirements, taking into account stakeholder expectations such as those of the Victorian Auditor‑General’s Office (VAGO). There will also be additional guidance included for departments and agencies about how to streamline their respective financial reports.

Departmental representatives have been consulted on the proposed structure of the streamlined financial statements to facilitate early engagement, planning and transition to the streamlined format. Agencies are encouraged to liaise with their portfolio department’s finance contact for guidance.

In the meantime, departments and agencies are encouraged to start preparing for changes to their existing financial statements by:

* integrating the relevant accounting policies in Note 1 *Summary of Significant Accounting Policies* with the corresponding disclosure notes to the financial statements, and removing duplicate accounting policies; and
* reordering the disclosure notes within their existing financial statements to better communicate the entity’s operations and outcomes.

The *2015‑16 State of Victoria’s Annual Financial Report,* which is available on DTF’s website, can be used by departments and agencies as an illustrative example of the streamlined financial statements before the model streamlined financial statements become available.

Other updates to the Model Report will include revisions for new and revised accounting standards and financial reporting directions (FRDs), and also the standard self‑declaration certificate, management checklist and associated guidance for the implementation of AASB124. Consistent with previous practice, DTF’s responses to the recommendations from Public Accounts and Estimates Committee (PAEC) and VAGO will be incorporated where appropriate.

More details regarding updates and changes for the streamlined *2016‑17 Model Report* will be communicated in the coming weeks.

### AASB 124 Related Party Disclosure project

The revised AASB 124 issued by the Australian Accounting Standards Board (AASB) will be applicable for not‑for‑profit public sector entities from **1 July 2016** (i.e. from the **2016‑17 financial year**), with no comparatives required for the first period to which these changes apply. December year‑end reporters will apply the accounting standard from **1 January 2017**. The accounting standard requires ministers and other key management personnel (KMP) of entities to disclose the remuneration and related party transactions. Typical or usual citizen transactions are not required to be disclosed – these may include paying personal taxes, receiving a social welfare benefit, public health benefit, student allowances or paying licence fees.

The standard defines KMP as those people with the authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, i.e. those charged with strategic decision making responsibilities.

* As Cabinet is the principal decision making body of the government, all cabinet ministers are considered KMP of the State\*.
* Portfolio ministers are responsible for the oversight of their relevant portfolio departments and entities, and are therefore considered as KMPs of their representative portfolio entities. Departments and agencies would also need to assess which executives meet the definition of a KMP for their respective departments and agencies.
* For agencies with a board, members forming the governance board are considered as having strategic decision‑making authority for the planning, directing and controlling of the overall activities of the entity and would be considered KMP of the agency.

A related party is defined as a person or an entity related to the reporting entity that is preparing its financial statements. This includes:

* KMP of the reporting entity or its parent entity (i.e. the State); or
* a close family member of the KMP; or
* the KMP or close family member’s personal related entities (for example, companies, partnerships, interest in joint ventures, etc).

Personal related entities include any entities that the KMP, or their close family member:

* has significant influence; or
* has control or joint control over.

As all cabinet ministers are considered KMP of the State, they are also related parties of the State and all its controlled entities (i.e. departments and agencies)\*.

KMPs will self‑declare their related party transactions and only provide personal details of their related parties where there are transactions to declare. This reduces the risk of personal security and privacy to the KMPs and their families. A proposed $10 000 threshold may be applied to ongoing standard business transactions to ease the burden of onerous disclosures as agreed with VAGO. All other related party transactions will be required to be declared regardless of amount, as some related party transactions may be material by nature rather than by amount. **Please note that the proposed implementation approach for AASB 124 will be finalised subject to Cabinet consideration in the new year.**

A declaration certificate with guidance and examples will be made available to ministers and other KMPs for completion. An accompanying management checklist will also be provided to preparers of departmental and agency financial reports to support management assurance of the completeness of their related party disclosures. These documents as well as frequently asked questions and disclosure examples will be included in the *2016‑17* *Model Report* and published on DTF’s website.

It is currently proposed that data collection for ministers will be managed centrally. Departments and agencies are required to develop their own internal processes for executive KMP’s data collection. Not all information collected will be disclosed in the respective annual reports. This is because the accounting standards only require the disclosure of material related party transactions and outstanding balances. In addition, items of a similar nature may be disclosed in aggregate except where separate disclosures are necessary for an understanding of the effects of related party transactions on the entity’s financial statements, i.e. individual transactions that are unusual in nature or significantly material by amount.

### Interim valuation assessments

VPS entities are required to conduct annual fair value assessments for each class of non‑financial physical assets. These interim assessments are the responsibility of management, and should be documented as the auditor may request this information to support the carrying value of assets.

The methodology of VGV land indices is an important factor to be considered in fair value assessments and has been updated for selected metropolitan and high growth areas. A summary of the key points for interim assessments is provided below as a quick reference for departments and agencies.

#### VGV land indices for selected metropolitan areas

The VGV provides land and building indices every six months for all Victorian postcodes based on annual changes (financial year and calendar year). The indices are published in the secure area of the DTF website every October (covering the period 1 January to 31 December) and April (covering the period 1 July to 30 June).

Entities with 30 June reporting periods are encouraged to use the VGV calendar year indices issued in October to perform interim assessments of their assets to determine whether any material movements in fair value have occurred. Entities with 31 December reporting periods are encouraged to use the financial year indices issued in April to perform interim fair value assessments.

In response to a recommendation by VAGO in its audit report *Public Asset Valuation*, the VGV has engaged Certified Practicing Valuers to carry out benchmark assessments within selected metropolitan areas to better capture the volatility of recent market movements. The indexation factors for the benchmark areas and the corresponding postcodes have been incorporated into the October land indexation factors released in November 2016. The value of the same properties will be assessed on a regular basis and VGV will continue to provide the indexation factors using the current modified approach.

#### Key points for interim assessments

Key points for VPS entities to note when performing interim assessments include:

* Fair value assessments should be conducted annually (between formal scheduled revaluations) using appropriate fair value indicators, which include the VGV land and building indices and other relevant factors.
* This assessment should take into consideration the appropriate fair value indicators to determine whether any material (greater than 10 per cent but less than 40 per cent) or exceptionally material (greater than 40 per cent) changes in the asset’s value has occurred.
* For **land**, entities may use the VGV land indices, which are based on the post code of each property. Indices are provided for each of the land types – residential, industrial, commercial and Englobo (development land), and entities should adopt the appropriate indices depending on the zoning of land, rather than what it is being used for.
* **Infrastructure assets** valued on a depreciated replacement cost (DRC) basis should be assessed against relevant indices for the cost of construction.
* For **non‑specialised buildings** valued on a market value basis, no separate indices are produced by the VGV. Entities may use the land indices, which are based on market values, as a guide for their assessment.
* For **specialised buildings** valued on a DRC basis, entities may use the VGV building cost indexation factors on the DTF website for their assessment.
* Assessment of movements in asset values against the appropriate indices is on a compounding or cumulative basis. This means movements should be considered in aggregate for the interim years between last managerial/formal scheduled revaluations (i.e. years 1 to 4).

An illustrative example of how indices should be considered on a cumulative basis is provided below:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Valuation** | **Year 1** | **Year 2** | **Year 3** | **Year 4** |
| Annual indices rate | 1.09 | 1.11 | 1.12 | 1.08 |
| Valuation at 30 June Year 0: $1,000 | 1 090  | 1 210  |  1 355  | Pending3  |
| Compounded indices rate since Year 0 | 1.09 | 1.21 | 1.36 | 1.46 |
| Action required | None1 | Managerial2 | Managerial2 | Formal3 |

1. No action is required as there is only a 9 per cent increase from the last valuation.
2. Managerial valuation is required as there is a more than 10 per cent increase since the last scheduled, interim or managerial revaluation (whichever is the most recent) but less than 40 per cent increase from the last formal revaluation.
3. Formal revaluation is required as there is a more than 40 per cent increase since last formal revaluation.

If an adjustment to the asset’s fair value is triggered, entities should ensure they adjust the book value of the asset by the appropriate indexation factor before adjusting for depreciation. Note that this process should be performed on an asset‑by‑asset basis, as the level of depreciation may vary for different types of assets.

### Reclassification of non‑financial physical assets as ‘held for sale’

Assets are considered to be ‘surplus’ when they no longer contribute to an entity’s current or future service delivery needs. When approval has been sought from the relevant authority to sell or transfer the surplus asset, entities can engage the assistance of the DTF Commercial team to seek a suitable sale or transfer plan.

During this process, the surplus asset remains an asset of the entity that continues to be recognised in their financial statements. As a result, entities need to determine whether the surplus asset should be reclassified in accordance with relevant accounting standards.

DTF has developed a checklist and accompanying guidance to assist VPS entities in determining when to reclassify surplus non‑financial physical assets as ‘held for sale’ in compliance with the requirements of AASB 5 *Non‑current Assets Held for Sale and Discontinued Operations*, which will be available in the Financial Reporting Policy section of the DTF’s website in the coming weeks.

### VPS operating manual on machinery of government changes

The *VPS operating manual on machinery of government changes* was published in the Government Financial Management area of DTF’s website in October 2016. The manual provides a comprehensive source of guidance to assist departments in implementing machinery of government changes.

The manual relates primarily to transfers of responsibilities and people between Victorian government departments under the *Administrative Arrangements Act 1983*, the *Public Administration Act 2004* and the *Financial Management Act 1994*. It also covers changes in portfolio responsibilities for non‑departmental entities including the related impacts on the relationship between a relevant department and a government‑controlled agency, and the accounting for the investment in that entity regardless of whether or not the agency is directly involved in the transfer of departmental functions. In addition, sample documents have been provided to assist departments in the planning and execution of what can be complex movements of functions and responsibilities between departments and their portfolio agencies.

## Financial reporting directions and guidance notes

Since the last newsletter, FRD 25C *Local Jobs First – Victorian Industry Participation Policy* (VIPP) has been updated to reflect reporting outcomes endorsed by Cabinet in July 2016 as a result of a review performed by the Department of Economic Development, Jobs, Transport and Resources. The review examined how VIPP is applied across government and sought to identify ways to maximise opportunities for local small and medium enterprises and reduce red tape. The revised FRD 25C is applicable from 1 July 2016, and the key changes include:

* the introduction of a minimum 10 per cent formal weighting for local content when evaluating tenders for Local Jobs First – VIPP applicable projects, to be applied for all contracts commencing on or after 1 September 2016;
* rebranding of the VIPP to ‘Local Jobs First’ to sit alongside the legislative VIPP brand; and
* removal of the requirement to report on skills/technology transfer outcomes for contracts commenced or completed during the reporting period.

Other proposed FRD changes applicable to the 2016‑17 reporting period include:

* FRD 15C Executive officer disclosures in the Report of Operations;
* FRD 21B Disclosures of responsible persons, executive officers and other personnel in the financial report; and
* FRD 29A Workforce data disclosures in the Report of Operations – Public Service Employees.

Revisions to these FRDs will align the definition of ‘remuneration’ with AASB 124 *Related Party Disclosures* and the remuneration banding for executive officers will be expanded to reflect the five disclosure categories prescribed in AASB 124, which include short‑term, long‑term and other long‑term employee benefits, termination benefits and share based payments. Updates to the reporting of executive remuneration will also be made following the review by the Victorian Public Sector Commission and their recommendations raised in 2016.

More details regarding the changes to FRD 15C, FRD 21B and FRD 29A will be communicated as soon as they are finalised and also in the July 2017 newsletter.

# 2016‑17 financial reporting legislation

### Standing Directions

The *Standing Directions of the Minister for Finance 2016* (2016 Standing Directions) were issued by the Minister in February 2016, with an application date commencing 1 July 2016 onwards. As a result, the *Standing Directions of the Minister for Finance 2003* (2003 Standing Directions) have been superseded.

For entities with annual reporting on a calendar year from 1 January to 31 December, it should be noted that their reporting period overlaps two different reporting periods, as a result, both the 2003 and 2016 Standing Directions will apply (i.e. 2003 Standing Directions apply from 1 January to 30 June and 2016 Standing Directions apply from 1 July to 31 December).

Although the 2016 Standing Directions are the primary reference as they are applicable at the time of reporting, if the differences between the two Standing Directions are significant, entities are required to comply with the applicable Standing Directions for that respective period (entities are strongly recommended to include an explanatory footnote with their disclosure index to explain variations in reporting requirements and disclose for the full year, notwithstanding the respective Standing Directions only apply for half of the year).

If you have any further queries on the Standing Directions, please direct your queries to the DTF Financial Frameworks team mailbox: standing.directions@dtf.vic.gov.au.

## Other guidance

### Superannuation Guarantee Levy

The Superannuation Guarantee Levy (SGL) schedule has been updated in accordance to 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 for seven years, before making yearly increments of 0.5 per cent from 2021 to 2025.

The next SGL rate change for departments and agencies will be effective from 1 July 2021 when the rate will increase to 10 per cent.

### 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 entities in ascertaining their financial position for the year‑end.

Entities are reminded to **remeasure their provisions** to ensure that any material movements arising from the wage inflation rate and discount rates are reflected during the current reporting period.

The rates for 31 December 2016 will be distributed at the beginning of January 2017. In the recently released *2016‑17 Budget Update*, the forecast Victorian wage inflation index for the coming four years has decreased by 0.3 per cent on average, in comparison with the forecast published in the *2016‑17 Budget*. As a result, the wage inflation rate for 31 December 2016 is expected to decrease by a similar quantum.

DTF will continue to provide wage inflation and discount rates to be used with the 2008 Long Service Leave (LSL) Model and the previously released 2004 LSL Model. The discount rates applicable for the 2004 LSL Model are based on bond rates with different maturity periods, while the 2008 LSL Model applies the single 10‑year bond effective rate consistent with the average leave settlement duration of 10 years.

## Key financial publication dates for the State of Victoria in 2016‑17

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

|  |  |  |
| --- | --- | --- |
| Reporting year | Publication | Anticipated release dates – actual dates to be confirmed |
| **2016‑17** | Mid‑Year Financial Report | Legislative due date is 15 March 2017. |
| **2017‑18** | Budget papers | Anticipated date is 2 May 2017. |
| **2016‑17** | The State’s Financial Report | Legislated due date is 15 October 2017. |
| **2016‑17** | Department and entity reporting | Legislated due date is 15 October 2017. Entities are encouraged to table their annual reports prior to the legislated due date. |

# AASB update

## Key AASB Standards and Exposure Drafts issued but not effective for 2016‑17

### AASB 9 *Financial Instruments*

AASB 9 *Financial Instruments* will supersede previous versions of the standard (AASB 9 (2014)) and AASB 139 *Financial Instruments: Recognition and Measurement*. It will apply to annual reporting periods beginning on or after 1 January 2018, with retrospective application.

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

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

AASB 15 *Revenue from Contracts with Customers* applies where there is an enforceable contract, imposing a sufficiently specific performance obligation on an entity to transfer goods or services. AASB 15 requires entities to only recognise revenue upon the fulfilment of the performance obligation. Therefore, entities need to allocate the transaction price to each performance obligation in a contract and recognise the revenue only when the related obligation is satisfied.

The effective date of AASB 15 for for‑profit entities is 1 January 2018 (the 2018‑19 reporting period), while the effective date for not‑for‑profit entities has been deferred to 1 January 2019 (the 2019‑20 reporting period), with respective comparative periods being the 2017‑18 and 2018‑19 reporting periods.

VPS entities are strongly encouraged to start reviewing the terms and conditions of their contracts to identify the various performance obligations within the agreements, as there may be different revenue recognition for each performance obligation.

DTF will be hosting working group consultations for departmental representatives to assist with implementing the standard and to quantify the financial impact of this new standard for the State.

### Exposure Draft 260 *Income of Not‑for‑Profit Entities* (New AASB 10XX)

For income recognition, not‑for‑profit entities will need to first assess if they have a contract with customers as defined by AASB 15, which must:

* be enforceable;
* contain performance obligations to transfer goods or services to another party that are sufficiently specific to enable determination of when the obligation has or has not been satisfied; and
* not result in the goods and services being retained by the entity.

If any of the above criteria fails, the transaction would be accounted for in accordance with the upcoming AASB 10XX *Income of Not‑for‑Profit Entities*. The draft AASB 10XX proposes immediate recognition in the operating statement for income without a contract with customers, except for the amount attributable to contributions by owners, liabilities, and transfersto enable an entity to acquire or construct a non‑financial asset to be controlled by the entity as described below.

The new standard may affect the timing of the grant revenue being recognised in the operating statement. Under the existing AASB 1004 *Contributions,* grant revenue is generally recognised when the cash is received. Under AASB 15 and AASB 10XX, recognition of the grant revenue in the operating statement will be deferred if there is any liability or other performance obligation (a promise to transfer a good or service) related to the cash or grant received, or the transfer is to enable an entity to acquire or construct a non‑financial asset to be controlled by the entity. VPS entities will need to start determining whether they have any enforceable contracts in place and whether performance obligations exist related to their grant arrangement.

A revised draft Standard AASB 10XX and implementation guidance was published in September 2016 on the AASB website for a fatal‑flaw review. The Board has since met and discussed the pre‑ballot draft of the Standard. The finalised standard is expected to be released by the end of 2016 or early 2017.

The major updates to the proposed standard (previously as Exposure Draft 260 *Income of Not‑for‑Profit Entities)* since *Accounting Policy Update – Issue no. 30 – July 2016* include:

* Transfers to enable an entity to acquire or construct a non‑financial asset to be controlled by the entity

For transfers made to enable an entity to acquire or construct a non‑financial asset for its own use, the draft standard defers the recognition of income until the entity satisfies the obligation to acquire or construct the asset.

To meet the definition of such transfer, the Board has tentatively decided that the non‑financial asset to be acquired or constructed by the entity must be one that will be recognised as an asset in accordance with the appropriate AAS. As a result, grants for research will be recognised immediately as the ‘research asset’ being developed cannot meet the asset recognition criteria of AASB 138 *Intangible Assets*.

The Board has also clarified that the deferral accounting applies only to the transfer of a financial asset. Transfers of non‑financial assets, such as building materials or land, to acquire or construct a non‑financial asset will not qualify for the specified accounting treatment.

* Volunteer services

Consistent with the current accounting requirements of AASB 1004, local governments, government departments, general government sectors and whole of governments are expected to recognise the inflow of resources in the form of volunteer services if the fair value can be measured reliably and the services would have been purchased if they had not been donated.

ED 260 also provides an option for any not‑for‑profit entity so that they **may** elect to recognise volunteer services if their fair value can be measured reliably, whether or not the services would have been purchased if they had not been donated. Provision of the option is to avoid unintended costs by mandating it.

* Licences

The scope of AASB 10XX has been amended to exclude licences outside the scope of AASB 15, e.g. regulatory licences (such as gaming licence) and licences for the use of non‑produced assets (such as mineral and water rights, fishing licences). For such licences, an entity would apply AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* in determining its accounting policies, which may result in applying the licence provisions of AASB 15 by analogy or the requirements of AASB 10XX as appropriate.

* Effective date

The proposed effective date of AASB 10XX has been deferred by one year to annual reporting periods beginning on or after 1 January 2019 to align with the application date of AASB 15 for not‑for‑profit entities.

### AASB 16 *Leases*

The AASB issued the new leasing standard AASB 16 *Leases* in February 2016 to supersede the existing standard AASB 117 *Leases*. It will apply for annual reporting periods beginning on or after 1 January 2019.

AASB 16 keeps the same accounting principles for lessors as in AASB 117. However, it eliminates the differentiation between operating and finance leases from the lessee’s perspective by introducing a single lessee accounting model.

Under this model, the lessee recognises most operating leases on balance sheet, with short term leases less than 12 months and low value leases as the only exemptions. Lessees will have to account for most leases in a manner similar to how finance leases are currently treated under AASB 117, recognising a right‑of‑use asset and a lease liability at the lease commencement date, and depreciating the asset and amortising the liability over the lease period.

The recognition of all lease assets and liabilities on balance sheet will increase the net debt of lessees. The net impact on their operating surplus is expected to be marginal. The presentation in the cash flow statement will also be affected, with the amounts of cash paid for the principal repayment of the lease liability classified under financing activities, and the amounts paid for the interest component being classified under operating activities.

In preparation for implementing this new leasing standard, VPS entities should:

* develop a register to capture all operating leases;
* review service agreements to determine if it contains an embedded finance or operating lease that will need to be segregated from the service element to be reported on balance sheet; and
* identify changes required to internal processes or systems in order to capture the necessary information for reporting purposes.

To assist entities with the implementation of this new standard, DTF will be hosting working group consultations with departmental representatives, and portfolio entities are encouraged to be in contact with their portfolio department representatives.

### ED 261 *Service Concession Arrangements*

ED 261 *Service Concession Arrangements* was issued by the AASB with an initial application date from
the 2017‑18 reporting period. However, it is anticipated that the issue of ED 261 as an accounting standard will be delayed with a potential application date from 1 January 2019 (the 2019‑20 reporting period).

ED 261 addresses accounting for service concession arrangements from a grantor’s perspective as there was previously no specific AAS to address the accounting for such arrangements. It prescribes the accounting treatment for public private partnership (PPP) arrangements where a private sector operator is providing a public asset or service to the State.

Currently, there are two types of PPP arrangements:

* social infrastructure PPPs where the public sector entity directly pays for the infrastructure, such as the arrangements for the construction of prisons, schools, hospitals. These are currently accounted for on balance sheet as a finance lease, with recognition on commercial acceptance (i.e. when they are available for service on completion of construction); and
* economic infrastructure PPPs where the State does not pay for the infrastructure, but instead provides the operator with the right to charge users of the asset (e.g. toll roads such as CityLink). This is not recorded on balance sheet until the asset is returned to the State.

Under the proposed new standard:

* there will be an earlier recognition of social infrastructure PPP’s on the balance sheet, at the earlier of commencement of construction or contractual arrangement. This will bring forward the timing of the corresponding liability’s recognition, and change the phasing profile of the net debt impact; and
* economic infrastructure PPPs will be brought onto balance sheet. The service concession asset will be recognised at its fair value with a corresponding deferred liability recognised as unearned revenue. This has no impact on net debt as it is not affecting financial asset or liabilities upon its initial recognition. The treatment may generate a positive impact on net result from transactions during the earlier years of the arrangement, because the phasing of depreciation over the useful life of the asset may be lower than the revenue recognised in each period over the shorter service concession period.

### Insurance contracts

The International Accounting Standards Board (IASB) has completed its substantive decision‑making on a forthcoming revised IFRS 4 *Insurance Contracts*. The AASB has been undertaking domestic work to consider the modifications that may need to be made in the equivalent new AASB standard, which would supersede the existing AASB 4 *Insurance Contracts*, AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance Contracts*.

The AASB will clarify the scope of the forthcoming new AASB insurance standard for public sector entities, to ensure similar activities are treated similarly. The Board has tentatively decided to include a public sector‑specific paragraph to avoid the consequence of public sector insurers to account for their long‑term (possibly perpetual) contracts using the ‘general model’ for liability measurement in the revised IFRS 4, which would involve considerably more work than the existing accounting. It has also noted the recognition principle of an onerous contract liability on a lower level of portfolio group in the new standard than the current practice adopted by Australian public sector insurers.

The IASB expects to release the revised IFRS 4 in the first half of 2017. The AASB will issue a revised AASB standard on insurance contracts based on the forthcoming IFRS standard, taking into account issues specific to the Australian public sector.

# VAGO communication

### Changes to auditor’s reports

VAGO have advised that there will be changes to the layout and content of auditor's reports for the 2016‑17 reporting period and periods going forward. The changes reflect an update to the relevant Australian auditing standards.

All entities will receive an auditor's report with the following key changes:

* the opinion paragraph will now be presented at the start of the auditor’s report;
* there will be increased detail of auditor’s responsibilities;
* there will be explicit commentary on management’s responsibilities in relation to going concern; and
* there is potential for an increased number of pages.

### Key Audit Matters

VAGO is taking a staged approach to the implementation of the new auditing standard, ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*, starting with material entities.

The 2016‑17 auditor's reports for material entities will include a section on key audit matters (KAMs). KAMs are matters which the auditor determines were of most significance to the audit, and are selected by taking into account areas of higher risk, significant auditor judgements, and the effect on the audit of significant events or transactions.

The KAM section of the auditor’s report will include:

* a brief description of the key audit matters;
* why VAGO considered them to be key to the audit; and
* what procedures were performed to address the matter.

In future years, VAGO plans to include KAMs in auditor's reports of all entities as it will improve the transparency of the audit process. VAGO will discuss this further with the relevant entities during the planning stage of their individual audit engagements.

# 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/publicsector/) 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.

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