

Implementation of New Accounting Standards: AASB 15 & AASB 16

Accounting Standards Working Group - Update | Tony Rocca & Danny Wain

Accounting Standards Working Group

- Overall purpose of the working group is as follows:
 - *‘drive and inform the development of consistent sector-wide approach to ensure compliance with the new accounting standards that apply to Local Government. With any introduction of new accounting standards, it can impact the way in which Council reports, as well as compliance requirements and will indeed influence the Financial Reporting Templates going forward.’*

AASB 16 - LEASES

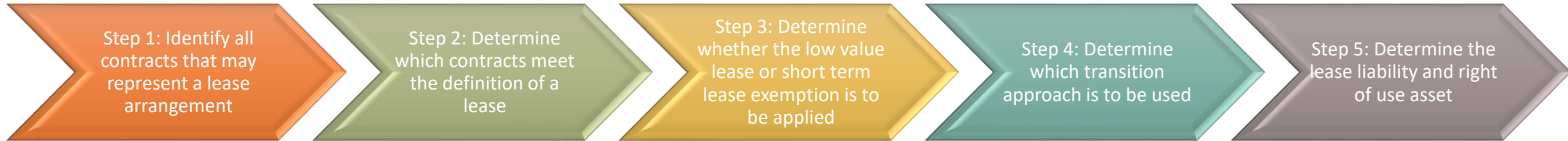
- AASB 16 *Leases* will supersede the existing AASB 117 *Leases*
- Adoption of the standard is to take place 1 July 2019
- Currently: Under the current accounting standard, the obligation to make future payments under an operating lease arrangement is not included on the balance sheet even though Council is committed to those future expenditures.
- Change: results in the inclusion of a lease liability and a right of use asset on the balance sheet – in other words, Council will now include the costs of use of the leased asset and the associated benefits on its balance sheet.

AASB 16 – LEASES

- Implications
 - increases the level of financial reporting risk given the increase in complexity and the hidden issues which may arise on implementing the new standard
 - It changes expenditure profiling and timing
 - In addition to the possible financial reporting anomalies, the right of use asset will be non-current whereas the lease liability will be split between current and non-current. This mismatch could potentially cause issues with working capital with a partly current liability funding a non-current asset.

- Positive
 - gives a more accurate representation of the financial position of the business by fully reflecting all its liabilities, and provides more useful information in financial reporting

AASB 16 – LEASES – Steps to Implementation



- Step 1: Some contracts that may represent a lease:
 - Waste Management Contracts
 - Leasing of Visitor Information Centre
 - Leasing of photocopiers/printers/computers
 - Fleet

AASB 16 – LEASES – Step 2 & 3

Worked Example – Waste Contract

Councils completing case study example	Does contract require utilisation of an asset?	Any element of contract where not clear/explicit?	Higher level details of contract.	Used purely for that contract?	Exclusive Use?	Greater than 12 months?	Materiality - based on liability rather than asset	Does a lease exist?	If there is, how do you split the cost?
Maroondah - JJs	Yes - total of 15 trucks with JJ Richards. 9 Garbage (8 which are used Monday to Wednesday and all 9 used Thursday & Friday). 3 Recycling trucks and 3 Green Organics Trucks	No	The trucks are all exclusive use and all co-signage. There are no additional collection vehicles that will be used during the contract. For general waste, approximately 181 bins collected per collection vehicle per hour. Recycling - 205 bins collected per vehicle per hour. Garden Organics - approximately 170 bins collected per vehicle per hour.	Yes	Yes	Yes - 10 years	Yes - definitely material, if that is a prerequisite to capturing the asset	Yes	Trucks cost approximately \$370,000. With 15 trucks, that is approximately \$5.5m or the total value of the trucks is \$555,000 p.a. for fleet of trucks or \$37,000 per truck p.a.

AASB 16 – LEASES – Step 3 Determine whether the low value lease or short term lease exemption is to be applied

Identifying the population: Recognition exemptions



Short term leases

≤ 12 months and
no purchase option

By class



Leases of low value items

E.g. \$5,000 when new
and not subject to a
sublease

Lease by lease

**Accounting Standards Working
Group and LGV to provide
mandated guidance!**

AASB 16 – LEASES – Step 4: Determine which transition approach is to be used

- We consider there to be only 2 approaches that can be implemented when transitioning to the new standard, they are:

Identifying the population: Applying lease definition

Apply the AASB 16 definition to ***all contracts***

OR

Grandfather existing contracts and apply the AASB 16 definition ***only to new or changed contracts***

PE 1

PE – practical expedient

Cost



Comparability



Accounting Standards Working Group and LGV to provide mandated guidance for Grandfathering approach to be implemented!

AASB 16 – LEASES – Step 4: Determine which transition approach is to be used

- Mandating the grandfathering approach means:
 - COUNCILS WILL NOT BE REQUIRED TO REASSESS WHETHER CONTRACTS ENTERED INTO PRIOR TO 1 JULY 2019 CONTAIN A LEASE;
 - RATHER – VARIATIONS TO CONTRACT OR CONTRACTS ENTERED INTO FROM 1 JULY 2019 WILL NEED TO BE CONSIDERED FOR LEASE IMPLICATIONS
- Low Value Thresholds:
 - LOW VALUE ASSET THRESHOLD WILL BE MANDATED TO BE IN ACCORDANCE WITH ORGANISATIONAL CAPITALISATION RULES

AASB 16 – LEASES – Step 5: Determine the lease liability and right of use asset

- Case Study – Waste Contract

Situation	Assessment	Comment
<p>Council has entered in a contract with Wasteful Industries for the collection of all waste</p> <p>The contract specifies that 15 vehicles are required</p> <p>Vehicles must be covered in Council's agreed signage</p> <p>Vehicles may not be used for other services or contracts</p> <p>Vehicles must meet certain minimum specifications</p> <p>The service will be delivered for a fixed monthly cost of \$270,000 or Cost Per Collection?</p> <p>The contract cost will increase by CPI on the 3rd, 6th, 9th and 12th anniversary of the contract</p>	<p>Is there an identified asset Yes</p> <p>Does Council have the right to obtain the benefits from using the asset Yes</p> <p>Is the contract greater than 12 months Yes</p> <p>Materiality Yes</p> <p>Does a lease exist Yes</p>	<p>The 15 vehicles</p> <p>Can direct and restrict usage of vehicles</p> <p>15n year</p> <p>Assumed</p>
<p><i>Information not in the contract</i></p> <p>Cost of finance to Council is 4%</p> <p>The type of truck specified in the contract (including compactor) costs approximately \$400,000</p>		

AASB 16 – LEASES – Step 5: Determine the lease liability and right of use asset

- Case Study – Waste Contract

Accounting Treatment:

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

Known parameters

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

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

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

Service component	\$225,619
Lease component	\$44,381
Total payment	\$270,000

Entry	Amount	Comment
Dr Right of Use (non-current asset)	\$6M	NPV of 180 monthly payments of \$44,381 at an annual finance cost of 4%
Cr Lease Liability	\$6M	
<i>To account for initial lease entry</i>		
Month 1:		
Dr Interest Expense	\$20,000	
Dr Lease Liability	\$24,381	
Cr Bank	\$44,381	
Dr Depreciation Exp	\$33,333	Straight line depreciation of right of use asset
Cr Right of Use (accum dep)	\$33,333	

AASB 15 – REVENUE FROM CONTRACTS WITH CUSTOMERS

- Adoption of the standard is to take place 1 July 2019
- Standard is complex and fundamentally changes the timing of revenue recognition
- Next Steps: The Working Group still working thoroughly to develop worked examples and Case Studies in conjunction with Crowe Horwath

AASB 15 – Worked Example

Grants received

The new standard clarifies the treatment of grants and other contributions received by Local Governments on the basis of whether those grants have specific and enforceable obligations attached.

Example:

Maroondah City Council (MCC) were granted \$1,000,000 in May 2020 to fund a new education program for the unemployed in their region during the FY 2021 year. As part of the grant MCC must assist at least 50 unemployed people during the year to gain employment. If MCC fail to spend the money during that period or provide the requisite services, they must return the funds.

Since the agreement is enforceable and the services to be provided are specific in nature then this transaction is dealt with under AASB 15 (revenue from a contract with the grantor).

AASB 15 - Worked Example - Grant

Year 2020

Account	Amount
Dr Cash	\$1,000,000
Cr Contract Liability	\$1,000,000

Year 2021

Account	Amount
Dr Contract Liability	\$1,000,000
Dr Expenses	\$1,000,000
Cr Cash	\$1,000,000
Cr Revenue	\$1,000,000

Accounting Standards Working Group - Next Steps

- Working Group – to work with LGV to draft mandated guidance in relation to AASB 16 Leases.
- As part of documenting this mandated guidance, the communication will include Case Studies similar to the Waste example in the presentation, for a number of differing examples
- Develop Case Studies for AASB 15 Revenue
- Will issue draft documentation to broader Working Group for consultation
- Another update will be provided to Finpro members in the next few months

Thank you!