REPORT TO AUDIT & RISK COMMITTEE

SUBJECT: **Model Accounts & New Accounting Standards:**
- ***AASB16 Leases;***
- ***AASB1058 Income for Not-for-Profit Entities and***
- ***AASB15 Revenue from Contracts with Customers.***

AUTHOR: **[insert here]**

Purpose

To provide the Audit and Risk Committee with an update on the City of XX'S (the City's) work to comply with *AASB 16 Leases, AASB 1058 Income for Not-for-Profit Entities* and *AASB 15 Revenue from Contracts with Customers.* These are new Accounting Standards which came into effect from 1 July 2019.

Report

This report provides an update on:
- Summary of changes to the 2019/2020 Model Financial Statements.
- Impact of the new Leases Standards on the 2019/2020 Financial Statements including the expected lease assets and lease liabilities.
- Further information regarding the potential effect of the new revenue standard for prior year and current year balances.

Background Information

Revised accounting standards covering revenue, income and leases will impact the financial reporting of Victorian councils in the 2019-2020 reporting period.

The most substantial changes expected to impact the City relates to the recognition of operating leases on the balance sheet (*AASB 16 Leases*) and the timing of revenue recognition in line with performance obligations (*AASB 15 Revenue from Contracts with Customers* & *AASB 1058 Income for Not-for-Profit Entities).*

Summary of changes to the 2019/2020 Model Financial Statements

The majority of changes to the model 2019/2020 Financial Statements are mostly due to the disclosure requirements from the changes in the accounting standards summarised below. 'General effects on Financial Statements' indicates the changes expected due to each change in accounting standard.

Appendix 1 includes a draft of the key headline Financial Statements format inclusive of these changes.

Impact of the New Standard – AASB 16 Leases

The Australian Accounting Standards Board has made substantial changes to lease accounting with the new Accounting Standard - *AASB16 Leases (AASB 16)*. The change removes the distinction between operating and finance leases for lessees, with most leases now being recognised on the lessees' balance sheet.

This new Standard is however more than an accounting change. The increased lease liabilities recognised on balance sheet is likely to raise more attention on leases at Council and management levels. Potential consideration of whether leasing is the most efficient means of obtaining access to assets and whether these assets, and which assets could be bought rather than leased.

General effects on Financial Statements

Effects	**Statement**	**Explanation**
↑ Lease Assets ↑ Financial Liabilities	Balance Sheet	Increase in non-current assets as requirement of recognising leases as a Right-of-use asset and a respective lease liability split between current and non-current
↓ Equity	Balance Sheet	Decrease as the carrying amount of lease assets is likely to reduce more quickly (with a higher interest expense at the beginning of the life of the lease) than the carrying amount of lease liabilities
↑ Expenses	Income Statement	Operating lease costs included in operating expenses will be replaced by interest expenses (Finance costs – leases) and Amortisation - right-of-use-assets
↑↓ Surplus/(deficit) for the year	Income Statement	Interest expenses are higher in the earlier years. Combined with Amortisation - right-of-use-assets this will accelerate expenses compared to operating lease expenses. The $$ impact on annual profit will depend on the lease portfolio.
↑ Cash from operating activities ↓ Cash from financing activities	Cash flow statement	Increase in cash from operating activities as the interest portion of lease payments will be classified as cash outflows from financing activities, instead of the entire operating lease payment being classified as a cash outflow from operating activities
↔ Total cash flow	Cash flow statement	No change expected as changes are related to reclassification of interest and principal in different sections of the cash flow statement

Expected implementation and compliance issues and costs for the City include, but are not limited to:

- Information system revision/changes – potential updates to the system to capture new information as required by the Standard, including potential new lease accounting software.
- Identifying a lease based on the new Standard definition – as part of the transition agencies can choose to reassess all ongoing contracts to determine if a lease is present. Some agencies will have a high volume and/ or complexity of lease contracts.
- Determining the discount rate – the need to determine the discount rate on a lease by-lease basis unless a practical expedient is used. At this stage, Financial Strategy has considered our leases to be of similar characteristics, and the outcomes would not be materially different from the Standard if implemented on a lease-by-lease basis.
- Training – compared to typical financial reporting changes, training will need to be extended well beyond the financial reporting team. All staff involved in leasing transactions will need a broad understanding that leases need to be identified and recorded. This has implications for contract management at the City.

Appendix 2 is a draft of the leases the City expects to hold at 30 June 2020 and the value of these leases.

Impact of the New Standard – AASB 15 Revenue from Contracts with Customers

AASB 15 Revenue from Contracts with Customers (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.

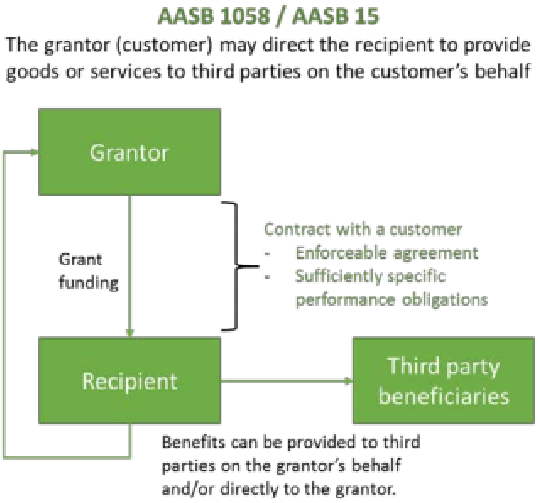
AASB 15 introduces a five-step revenue recognition model:

1. Identify the contract

2. Identify the performance obligations
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations
5. Recognise revenue progressively as individual performance obligations are satisfied.

The model specifies that revenue should be recognised when an entity (such as DEWLP) transfers control of goods/services (grant funding) to a customer (the City), at the amount to which the entity expects to be entitled. Depending on specific contractual terms, this may result in a change in the timing of revenue recognised.

Under the new framework of *AASB 15* and *AASB 1058 Income for Not-for-Profit Entities*, the key assessment is whether the grant is a 'contract with a customer' that falls within the scope of *AASB 15*. If so, the entity defers any grant monies received in advance in a 'contract liability' and recognises revenue when/as the performance obligations are satisfied. *AASB 15*'s scope includes arrangements where the grant recipient provides benefits to third parties on behalf of the grantor/customer.



General effects on Financial Statements

Effects	Statement	Explanation
↑ Revenue in Advance (Liability)	Balance Sheet	Increase in revenue in advance if funding received where the City hasn't met designated performance obligations.
↓ Equity	Balance Sheet	Decrease due to increased liabilities.
↓ Revenue	Income Statement	Decrease in revenue recognised if designated performance obligations aren't met.
↑↓ Surplus/(deficit) for the year	Income Statement	Consistent with decrease in revenue.
↔ Total cash flow	Cash flow statement	No change expected as changes are related to reclassification revenue and revenue in advance.

The City's current method is to recognise grant revenue upon receipt, with unspent funds being retained in a reserve. The Financial Statements require us to disclose the amount of unspent funding each year in the Notes to the accounts.

For the 2019/2020 Financial Statements we are required to assess each operating grant contract to determine if it meets the scope of *AASB 15*. This review is in progress and will be completed as part of the end of financial year processes.

Appendix 3 lists the Unspent Operating Grant Funding from 2018/2019, with amounts that could require adjusting from revenue to a liability.

Impact of the New Standards – AASB1058 Income for Not-for-Profit Entities

AASB 1058 Income for Not-for-Profit Entities (AASB 1058) is effective for Not-For-Profit (NFP) public sector agencies from the 2019/2020 financial reporting period and replaces most of the income recognition requirements in *AASB 1004 Contributions*.

The purpose of *AASB 1058* is to more closely recognise income, excluding contracts with customers (covered under *AASB 15*) in accordance with their economic reality. This may involve the deferment of revenue recognition to a future period, with that amount being retained as a liability.

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*, therefore needs to be considered in conjunction with *AASB 15*.

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 (that don't meet the specific performance obligations of *AASB 15*), bequests or donations
- Receipts of appropriations by government departments
- Assets acquired for nominal or low amounts

AASB 1058 also applies to Volunteer services.

General effects on Financial Statements

Effects	Statement	Explanation
↑ Revenue in Advance (Liability)	Balance Sheet	Increase in revenue in advance if funding received where the City hasn't met designated performance obligations.
↓ Equity	Balance Sheet	Decrease due to increased liabilities.
↓ Revenue	Income Statement	Decrease in revenue recognised if designated performance obligations aren't met.
↑↓ Surplus/(deficit) for the year	Income Statement	Consistent with decrease in revenue.
↔ Total cash flow	Cash flow statement	No change expected as changes are related to reclassification revenue and revenue in advance.

For the 2019/2020 Financial Statements we are required to assess each capital grant contract to assess if they meet the below criteria:

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

This review is in progress and will be completed as part of the end of financial year processes.

Appendix 4 lists the Unspent Capital Grant Funding from 2018/2019, with amounts that could require adjusting from revenue to a liability.

Volunteer Services

AASB 1058 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. The City's volunteer programs include the following:

- XXX PROGRAMS
- XXX FESTIVALS ETC. ETC.

Local Government Victoria however prohibited the recognition of volunteer services unless both of the following are met:

- the fair value of those services can be measured reliably; and
- the services would have been purchased if they had not been donated.

The valuation of volunteer services is a judgemental process and results in recognition of income and expenses with a nil net result in the income statement.

RECOMMENDATION

That the Audit and Risk Committee note the updated model changes for the financial statements; and note the work underway to ensure these changes are reflected for the 30 June 2020 Financial Statements.

Appendix 1

2019/2020 Financial Statements – Main Statements

Greater Bendigo City Council
2019/2020 Financial Report

Comprehensive Income Statement
For the Year Ended 30 June 2020

	Note	2020 $'000	2019 $'000
Income			
Rates and charges	3.1	-	117,147
Statutory fees and fines	3.2	-	5,211
User fees	3.3	-	27,022
Grants - operating	3.4	-	27,799
Grants - capital	3.4	-	8,056
Contributions - monetary	3.5	-	10,765
Contributions - non monetary	3.5	-	18,047
Initial recognition of assets		-	26,258
Interest on investments		-	1,704
Fair value adjustments for investment property	6.3	-	-
Share of net profits (or loss) of associates and joint ventures	6.2	-	27
Other income	3.7	-	6,572
Total income		-	**248,608**
Expenses			
Employee costs	4.1	-	64,498
Materials and services	4.2	-	73,214
Depreciation	4.3	-	37,274
Amortisation - intangible assets	4.4	-	592
Amortisation - right of use assets	4.5	-	-
Bad and doubtful debts		-	318
Borrowing costs		-	2,151
Finance costs - leases	4.6	-	-
Net gain (or loss) on disposal of property, infrastructure, plant and equipment	3.6	-	6,092
Other expenses	4.7	-	2,200
Total expenses		-	**186,339**
Surplus/(deficit) for the year		-	**62,269**
Other comprehensive income			
Items that will not be reclassified to surplus or deficit in future periods			
Net asset revaluation increment/(decrement)	6.1	-	65,031
Total comprehensive result		-	**127,300**

Shared from a Regional Council in case it assists other Council's. This paper has not been peer reviewed or audited.

Balance Sheet
As at 30 June 2020

	Note	2020 $'000	2019 $'000
Assets			
Current assets			
Cash and cash equivalents	5.1	-	75,930
Trade and other receivables	5.1	-	11,701
Inventories		-	196
Non-current assets classified as held for sale		-	250
Prepayments		-	1,012
Accrued revenue		-	920
Total current assets		-	**90,009**
Non-current assets			
Trade and other receivables	5.1	-	59
Investments in associates, joint arrangements and subsidiaries	6.2	-	3,273
Property, infrastructure, plant and equipment	6.1	-	1,597,149
Right-of-use assets	5.8	-	-
Investment property	6.3	-	-
Forestry plantations		-	82
Intangible assets	5.2	-	2,750
Total non-current assets		-	**1,603,313**
Total assets		-	**1,693,322**
Liabilities			
Current liabilities			
Trade and other payables	5.3	-	13,284
Trust funds and deposits	5.3	-	2,430
Unearned income	5.3	-	877
Provisions	5.5	-	16,311
Interest-bearing liabilities	5.4	-	3,960
Lease liabilities	5.8	-	-
Total current liabilities		-	**36,861**
Non-current liabilities			
Provisions	5.5	-	10,745
Interest-bearing liabilities	5.4	-	41,725
Lease liabilities	5.8	-	-
Total non-current liabilities		-	**52,470**
Total liabilities		-	**89,330**
Net assets		-	**1,603,992**
Equity			
Accumulated surplus		-	749,326
Reserves	9.1	-	854,666
Total Equity		-	**1,603,992**

Statement of Changes in Equity
For the Year Ended 30 June 2020

2020	Note	Total $'000	Accumulated Surplus $'000	Revaluation Reserve $'000	Other Reserves $'000
Balance at beginning of the financial year		-	-	-	-
Impact of change in accounting policy - AASB 15 Revenue from Contracts with Customers	10	-	-	-	-
Impact of change in accounting policy - AASB 1058 Income of Not-for-Profit Entities	10	-	-	-	-
Impact of change in accounting policy - AASB 16 Leases	5.8	-	-	-	-
Adjusted Opening balance		-	-	-	-
Surplus/(deficit) for the year		-	-	-	-
Net asset revaluation increment/(decrement)	6.1	-	-		-
Transfers to other reserves	9.1	-	-	-	-
Transfers from other reserves	9.1	-	-	-	-
		-	-	-	-
Balance at end of the financial year		-	-	-	-

2019		Total $'000	Accumulated Surplus $'000	Revaluation Reserve $'000	Other Reserves $'000
Balance at beginning of the financial year		1,476,692	691,257	752,124	33,311
Surplus/(deficit) for the year		62,269	62,269	-	-
Net asset revaluation increment/(decrement)	6.1	65,031	-	65,031	-
Transfers to other reserves	9.1	-	(17,774)	-	17,774
Transfers from other reserves	9.1	-	13,574	-	(13,574)
Balance at end of the financial year		**1,603,992**	**749,326**	**817,155**	**37,511**

Statement of Cash Flows
For the Year Ended 30 June 2020

	Note	2020 Inflows/ (Outflows) $'000	2019 Inflows/ (Outflows) $'000
Cash flows from operating activities			
Rate and charges		-	116,993
Statutory fees and fines		-	4,506
User fees		-	26,986
Grants - operating		-	25,241
Grants - capital		-	8,056
Contributions - monetary		-	10,765
Interest received		-	1,685
Trust funds and deposits taken/(repaid)		-	68
Other receipts		-	2,384
Net GST refund/payment		-	(211)
Employee costs		-	(63,594)
Materials and services		-	(75,300)
Net cash provided by/(used in) operating activities		**-**	**57,579**
Cash flows from investing activities			
Payments for property, infrastructure, plant and equipment	6.1	-	(50,429)
Proceeds from sale of property, infrastructure, plant and equipment	3.6	-	1,082
Payments for investments		-	-
Proceeds from sale of investments		-	-
Net cash provided by/(used in) investing activities		**-**	**(49,347)**
Cash flows from financing activities			
Loan repayments from heritage loans		-	42
Loan repayments by local organisations		-	14
Other financing activities		-	(35)
Finance costs		-	(2,151)
Proceeds from borrowings		-	3,000
Repayment of borrowings		-	(4,095)
Net cash provided by/(used in) financing activities		**-**	**(3,225)**
Net increase (decrease) in cash and cash equivalents		-	5,007
Cash and cash equivalents at the beginning of the financial year		75,930	70,923
Cash and cash equivalents at the end of the financial year		**75,930**	**75,930**

Financing arrangements	5.6
Restrictions on cash assets	5.1

Shared from a Regional Council in case it assists other Council's. This paper has not been peer reviewed or audited.

Statement of Capital Works
For the Year Ended 30 June 2020

	Note	2020 $'000	2019 $'000
Property			
Land		-	1,400
Buildings		-	17,964
Total property		**-**	**19,364**
Plant and equipment			
Plant, machinery and equipment		-	4,138
Office equipment, furniture and fittings		-	336
Fountains, statues and monuments		-	86
Total plant and equipment		**-**	**4,560**
Infrastructure			
Land improvements		-	1,281
Bridges		-	644
Sealed roads		-	13,796
Unsealed roads		-	3,120
Pathways		-	2,318
Drainage		-	2,526
Public furniture and fittings		-	2,820
Total infrastructure		**-**	**26,505**
Total capital works expenditure		**-**	**50,429**
Represented by:			
New asset expenditure		-	17,542
Asset renewal expenditure		-	29,313
Asset expansion expenditure		-	3,459
Asset upgrade expenditure		-	115
Total capital works expenditure		**-**	**50,429**

Appendix 2
Leases Expected to be Held at 30 June 2020

It is expected the City will have X leases which require disclosure on the Balance Sheet as at 30 June 2020. These leases are listed the table below.

Insert here a table with lease details with these headings:

#	Name of the lessor	Asset description *A brief description of the specified asset in the lease . E.g. photocopier, equipment*	Right -of- use asset category (leased asset type) *Land, Buildings, Equipment, Motor Vehicle, Other (please specify)*	Contract status *Active or not yet commenced*	Contract commencement date	Contract expiry date	Remaining contract term after the initial application date (month)	Monthly Rental $	Remaining contract consideration (nominal) ($)	Annual Increase	Incremental borrowing rate at initial application date

Value of Leases

The total value of the leases expected to be held as at 30 June 2020 is listed in the following table.

These leases have been discounted to Net Present Value using a weighted average of the City’s current borrowings as a discount rate. It should be noted that the net effect of these leases “on balance sheet” is zero. For each lease liability, there is a matching right of use asset.

Whilst the City is likely to commit to a form of agreement this financial year, a lease (or right to use asset) will not be in effect for a number of years until construction completed. However, it may be that heads of agreement (and future right to use) requires a form of disclosure. This will be discussed and investigated with our External Auditors in due course.

Appendix 3
2018/2019 Unspent Operating Grants Summary

The Operating Grants highlighted in green below have been identified as potentially requiring adjusting from revenue as these are typically grants where we are required to service a set number of people in the community, with funding to be returned if “not used”.

** Please note that this is only a preliminary assessment – further investigation is required.*

Unspent Amount	Department/Body	Grant NAME
$6,764,949		
$1,776,689		
$536,589	Dept of Premier	
$245,654	DHHS	
$226,554	DHHS	
$150,000	Creative Vic (DJPR)	
$71,299	DHHS	
$61,624	VicHealth Promotions	
$51,315	Dept of Premier	
$50,000	National Heavy Vehicle Regulator	
$45,356	DELWP	
$ 41,000	Creative Vic (DJPR)	
$36,446	Victorian Planning Authority	
$35,500	DHHS	
$32,000	Creative Vic (DJPR)	
$30,000	DET Early Years	
$27,681	DHHS - HACC	
$25,416	Aust Council for the Arts	
$25,393	Victorian Planning Authority	
$20,000	DJPR	
$15,448	DEDJTR	
$15,000	DHS	
$14,945	Dept Education & Training	
$10,691	VicHealth Promotions	
$6,760	Vic Health Promotion Foundation	
$ 3,701	DHHS	
$10,320,010		

Appendix 4

2018/2019 Unspent Capital Grants Summary

All amounts listed below are potentially requiring adjusting from revenue to a liability. This is based on the assumption that they meet the following criteria:

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

**Please note that this is only a preliminary assessment – further investigation is required.*

Unspent Amount	Department/Body	Grant
$230,948	DHS	
$220,000	DHHS	
$200,000	DHHS	
$41,472	DHHS	
$10,000	Final Claim	
$68,891	Emergency Management Victoria	
$40,000	DELWP	
$43,000	Emergency Management Victoria	
$350,000	Prior Year	
$1,204,311		