QUEENSLAND TREASURY

Financial Reporting Requirements for Queensland Government Agencies

CHAPTER 4 – FRR 4A to FRR 4F

Applicable to 2025/26 or 31 December 2026 Financial Years

DELIVERING FOR QUEENSLAND

Queensland Government

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FRR 4A Statement of Financial Position

INTRODUCTION

Policy items, indicated by **shaded bold print**, form the Minimum Reporting Requirements (MRRs).

Pursuant to sections 38(2) and 39(2) of the *Financial and Performance Management Standard 2019* (FPMS), departments and statutory bodies must prepare their financial statements in accordance with the MRRs. All of the MRRs are mandatory for departments. Statutory bodies comply with the FPMS by applying the parts of the MRRs that are considered relevant to their circumstances.

Application guidance, indicated by indicated by plain text under the Application Guidance sub-headings, provides support on interpreting and applying the mandatory policy items and other matters.

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4A.1 STATEMENT OF FINANCIAL POSITION

REFERENCES

- AASB 101 *Presentation of Financial Statements*
- FRR 2D *Form and Content of Financial Statements*

POLICY

- **Subject to FRR 2D.1, the required line items for the Statement of Financial Position are as outlined in the corresponding model financial statements unless the line items are not applicable to the entity.**
- **Agencies are permitted to use the title "Balance Sheet" in place of "Statement of Financial Position".**
- **Except where an accounting standard requires otherwise, assets and liabilities must be categorised either as current or non-current. All agencies are deemed to have an operating cycle of 12 months for the purposes of classifying current and non-current assets and liabilities.**
- **The amount of each material class of asset and liability comprising the line items in the Statement of Financial Position must be disclosed in the Notes to and forming part of the financial statements.**
- **The line item for 'Other' assets/liabilities must not exceed 10% of the value of total assets/liabilities.**
- **The Paid Parental Leave scheme is to be accounted for through the Statement of Financial Position with no transactions via the Statement of Comprehensive Income. (Refer to FRR 3C Employee Benefits Expense and Key Management Personnel Remuneration).**

APPLICATION GUIDANCE

Classification of Liabilities

Liabilities should be classified according to their nature e.g. payables, financial liabilities and provisions. This assists users to identify significant characteristics of the performance, financial position and financing activities of the agency. However, where line items such as interest-bearing liabilities provide more relevant information due to their size, nature or function, then they can be listed separately on the Statement of Financial Position. Liabilities should be classified as either current or non-current as required by AASB 101.

4A.2 STATEMENT OF ASSETS AND LIABILITIES BY MAJOR DEPARTMENTAL SERVICES, CBUs AND SSPs

REFERENCES

- AASB 101 *Presentation of Financial Statements*
- AASB 1052 *Disaggregated Disclosures*

POLICY

- **A separate column for each major departmental service, Commercialised Business Unit (CBU) and Shared Service Provider (SSP) must be included in the Statement of Assets and Liabilities by Major Departmental Services, CBUs and SSPs. This statement must be prepared and included in the financial statements of each department that has more than one departmental service.**

- **Major departmental services must accord with those included in that financial year's Service Delivery Statements (SDS), including any approved variations. If the SDS does not disclose any major departmental services, a Statement of Assets and Liabilities by Major Departmental Services, CBUs and SSPs must still be prepared as required by paragraph 16 of AASB 1052 if there is more than one major activity.**

- **The Statement of Assets and Liabilities by Major Departmental Services, CBUs and SSPs must disclose the assets deployed and liabilities incurred in the (controlled) Statement of Financial Position that can be attributed reliably to each major departmental service, CBU or SSP.**

- **Assets and liabilities must be disclosed according to the categories presented on the face of the department's Statement of Financial Position.**

- **Inter-service/unit balances must be reflected on a gross basis (i.e. before elimination) in the respective departmental services columns and eliminated in the "Inter-service/unit Eliminations" column so as to reconcile with the figures reported in the (controlled) Statement of Financial Position.**

- **Where there has been an approved change in activities from the comparative period, this should be disclosed in the Notes to and forming part of the financial statements and restated comparative figures disclosed, unless impracticable, in the Statement of Assets and Liabilities by Major Departmental Services, CBUs and SSPs.**

- **Where a department provides material amounts of non-activity related departmental services to other entities on a 'fee for service' arrangement, the 'General – Not Attributed' column should be used to record the assets and liabilities from these departmental services.**

APPLICATION GUIDANCE

To ensure that the Statement of Assets and Liabilities by Major Departmental Services, CBUs and SSPs accurately represents the (Controlled) Statement of Financial Position, Departments are expected to take due care to reliably classify all assets and liabilities to each major departmental service.

FRR 4B Assets

INTRODUCTION

Policy items, indicated by **shaded bold print**, form the Minimum Reporting Requirements (MRRs).

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Application Guidance, indicated by plain text under the "Application Guidance" sub-headings, provides support on interpreting and applying the mandatory policy items and other matters.

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4B.1 APPLICATION OF NON-CURRENT ASSET POLICIES

REFERENCES

- Non-Current Asset Policies for the Queensland Public Sector (NCAPs)

POLICY

- **Agencies must comply with the Non-Current Asset Policies (NCAPs) when accounting for its non-current assets (including property, plant and equipment, intangibles, investment property), as required by the *Financial and Performance Management Standard 2019* subject to other specific legislative provisions for particular agencies.**

- **NCAP 1, Appendix 1.1 Non-Current Asset Classes and Thresholds specifies the mandatory asset recognition threshold and subsequent measurement method (at cost or fair value) for each asset class, to the extent that such assets are not classified as investment property or as held for sale.**

- **In respect of land under roads, the notes to the financial statements must disclose, in addition to the disclosures applicable to the entire land class:**
  - **the aggregate value of land under roads at reporting date;**
  - **the methodology to identify land under roads;**
  - **the valuation methodology applied to determine the fair value of land under roads; and**
  - **if no reliable value can be determined, the nature of the contingent asset.**

APPLICATION GUIDANCE

Agencies are directed to Treasury's website for the latest version of the NCAPs.

Asset valuation methods must be consistent within asset classes presented in note disclosures. Agencies should refer to the Sunshine Department Illustrative Financial Statements for a suggested approach to the disclosure requirements of AASB 13.

Asset revaluation issues have, in past years, been the most common cause of agencies not meeting deadlines under the FA Act for the preparation and audit of annual financial statements. Treasury recommends agencies undertake early engagement with valuers in July/August to plan their revaluation process, to enable most of the revaluation effort to be accomplished by 31 May. By 31 May it is recommended that the valuations are obtained for all material classes of assets carried at fair value, and that all supporting workpapers are prepared and reviewed by management. This should enable adequate time for external audit review and negotiation of any contentious issues.

Treasury does not require the disclosures "encouraged" in paragraph 79 of AASB 116 or paragraph 128 of AASB 138 to be disclosed in agency financial statements.

4B.2 INVESTMENT PROPERTY

(withdrawn, refer instead to FRR 4B.1)

4B.3 INTANGIBLE ASSETS

(withdrawn, refer instead to FRR 4B.1)

4B.4 INVENTORIES

REFERENCES

- AASB 102 *Inventories*

APPLICATION GUIDANCE

A not-for-profit agency may hold inventories whose future economic benefits or service potential are not directly related to their ability to generate net cash inflows. For example, hospitals may hold stores of medicines or surgical supplies that are given to patients, or used in their treatment, either free of charge or for a fraction of their cost. These types of stores may qualify as inventories held for distribution – refer paragraph Aus9.2 of AASB 102.

Agencies should use professional judgement in determining which inventories should be classified as held for distribution. However, the inventories should be integral to the agency's service delivery. Annual reports, pamphlets, promotional materials, forms and guidelines would typically not constitute inventory held for distribution.

4B.5 ASSETS ACQUIRED AT NO OR NOMINAL COST

(withdrawn, refer instead to FRR 4B.1)

4B.6 IMPAIRMENT

(withdrawn, refer instead to FRR 4B.1)

4B.7 RESTRICTED ASSETS

REFERENCES

- AASB 7 *Financial Instruments: Disclosures*
- AASB 107 *Statement of Cash Flows*
- AASB 116 *Property, Plant and Equipment*
- AASB 138 *Intangible Assets*
- NCAP 3.4 Application of Fair Value Concepts (Highest and Best Use)

POLICY

- **Where restrictions have been imposed, whether by legislation or otherwise, on the manner in which an agency can utilise assets under its control, and such restrictions are material, the nature of the restrictions and the carrying amount of the affected assets must be disclosed in the notes to the financial statements.**

APPLICATION GUIDANCE

For the purposes of the policy, any gifts/bequests of assets that have conditions attached as to how they are to be utilised are considered to be restricted assets and, as such, are to be included in the restricted assets disclosure. Assets that need to be considered for this disclosure include financial instruments (including cash) in addition to property, plant & equipment and intangible assets. This disclosure should also consider assets with restrictions that have been identified in determining fair value for the purposes of AASB 13.

4B.8 GOODS AND SERVICES TAX (GST) RECEIVABLES/PAYABLES

REFERENCES

- Interpretation 1031 *Accounting for the Goods and Services Tax (GST)*

POLICY

- **At each reporting date:**
  - **the net receivable from/payable to the ATO must be classified according to the 'net' position; and**
  - **the gross amount of input tax credits receivable from the ATO and the gross GST payable to the ATO, must be separately disclosed in the notes.**

APPLICATION GUIDANCE

Interpretation 1031 requires GST relating to receivables and payables be recognised, but is silent on the issue of GST relating to accrued revenues and expenses.

GST legislation states that a liability (i.e. GST payable) occurs when a tax invoice has been issued for a taxable supply or a payment received for a taxable supply, whichever occurs earlier. The same rule applies to the entitlement to claim an input tax credit (i.e. GST receivable) either when a tax invoice is received for a taxable supply or a payment is made for a taxable supply, whichever occurs first.

An 'accrual' becomes a 'creditor' when an invoice is received with an invoice date within the financial reporting period. As a general rule, accrued liabilities are to be recognised exclusive of GST while creditors are inclusive of GST.

Invoices received after financial year end must be recognised as liabilities inclusive of GST (if material) if the tax invoice is dated prior to year-end. These represent creditors at balance date due to the supply of goods or services prior to the end of the financial year.

If the invoice is dated after year end for services provided prior to the year end, there is no entitlement to an input tax credit at balance date and therefore, the liability is an accrual and must be recorded exclusive of GST.

Any GST-inclusive liabilities recognised after the submission of the BAS will result in the need for a reconciliation of figures between the financial statements and the BAS (the latter having been determined based on general ledger figures as at the dated submission of the BAS).

Payments received in advance of a tax invoice being issued by the agency trigger a GST liability and corresponding liability to remit GST according to the GST legislation. Such a prepayment received prior to the year-end must be reported inclusive of GST.

When no tax invoice has been issued or no payment has occurred, accruals for revenues and expenses (that result in receivables and payables) should be reported exclusive of GST, as they represent an estimate only of charges that have been neither invoiced nor paid.

For information on the policy regarding the disclosure of GST in the Statement of Cash Flows, refer to FRR 5A Statement of Cash Flows.

4B.9 LEASES

REFERENCES

- AASB 16 *Leases*

POLICY

- **Agencies shall not apply AASB 16 to leases of intangible assets.**

- **Agencies shall apply AASB 16 paragraphs 6–7 to account for all short-term leases. A short-term lease is a lease that, at the commencement date, has a lease term of 12 months or less and does not contain a purchase option.**

- **Agencies may choose, on a lease-by-lease basis, to account for leases of low value assets either on balance sheet or by applying AASB 16 paragraph 6. A low value asset is an asset that costs less than AUD $10,000 when new.**

- **Non-lease components within lease contracts must be accounted for separately for all leases except for leases of plant and equipment. For leases of plant and equipment, the lease component and non-lease components must be accounted for as a single lease component.**

- **Right-of-use assets for peppercorn leases must be measured at cost on initial recognition.**

- **Subsequent to initial recognition, all right-of-use assets shall be measured at cost.**

- **Where the interest rate implicit in the lease is not specified in the lease agreement or otherwise provided by the lessor, agencies shall use their incremental borrowing rate to discount the lease liability.**

- **For incremental borrowing rates, agencies shall use agency-specific loan rates provided by QTC where applicable, or otherwise use QTC Fixed Rate Loan rates that correspond with the lease commencement month and lease term.**

- **Where internal-to-government finance lease arrangements exist, the head lessor agency shall, in order to facilitate whole-of-government reporting, be responsible for ensuring accurate accounting records are maintained (either by themselves or the**

lessee) for the underlying asset so it is properly accounted for by whole-of-Government under the applicable Standard (e.g. AASB 116).

APPLICATION GUIDANCE – LESSEES

Under AASB 16 Leases, a lessee no longer distinguishes between operating leases and finance leases. The lessee is required to recognise a right-of-use asset and a lease liability for all leases other than short-term leases and leases of low value assets.

Right-of-use asset

A right-of-use asset recognised under AASB 16 represents the agency's intangible right to use the underlying asset over the lease term, rather than the underlying asset itself. Valuation of the right-of-use can be significantly more complex than valuing the physical asset, as it needs to take into account, for example, the period of use and any restrictions on the use of the asset. Accordingly, Treasury requires that right-of-use assets be measured using the cost model.

Because the low value asset threshold already determines whether or not leases need to be accounted for on balance sheet, the asset recognition thresholds in NCAP 1 are not applicable to right-of-use assets.

Concessionary ("Peppercorn") leases

AASB 16 currently allows not-for-profit lessees to elect, on a class-by-class basis, to measure right-of-use assets arising from concessionary leases at fair value at initial recognition. For this purpose, AASB 2019-8 also permits that right-of-use assets arising from concessionary leases can be treated as a separate class to right-of-use assets arising from other leases, despite their similar nature and use in the entity's operations.

However, due to the cost and complexity in determining the fair value of right-of-use assets, Treasury currently requires agencies to measure all right-of-use assets arising from concessionary leases at cost on initial recognition – i.e. by applying AASB 16 paragraphs 23-25. This may result in small or nominal right-of-use asset values. Treasury's policy directive will be reviewed in future financial years in response to any amendments to the Standard as foreshadowed by the AASB.

Determining the lease term

It is important to correctly assess the lease term as only those lease payments during the lease term are included in the lease liability measurement. The lease term is the non-cancellable period plus extension periods that the lessee is reasonably certain to exercise and early termination periods that the lessee is reasonably certain not to exercise. "Reasonably certain" should reflect a very high probability.

For example, an agency enters into a 5-year lease of a building with a 2-year extension option, and the agency can cancel the lease at any time without penalty by giving 6 months’ notice. In this case:

- The minimum non-cancellable period is 6 months;
- The agency must assess whether it is reasonably certain to not terminate the lease before the 5-year lease term is up. The agency determines that it is reasonably certain to lease the building for the full 5 years (i.e. not terminate early), so it adds an additional 4 years and 6 months to the lease term;
- The agency then assesses whether it is reasonably certain to exercise the 2-year extension option. It determines that it is not reasonably certain to extend, so the lease term remains at 5 years.

Some leases may have an indefinite lease term and continue an ongoing basis into perpetuity until a party terminates the arrangement. For such leases, agencies should consider the following when determining the lease term for such arrangements:

- Whether there is an implied lease term or a reliably estimable time period over which the agency is reasonably certain to lease the asset that may be appropriate to use as the lease term;
- For assets with finite useful lives, such as buildings, the lease term cannot exceed the economic life of the asset itself;
- For leases of land which has an infinite life, the agency should assess whether it is reasonably certain to lease the land indefinitely. In some situations, agencies may be able to use a perpetuity formula to calculate the lease liability and not depreciate the right-of-use asset. Often these perpetual land leases are also peppercorn leases and will be immaterial for the lessee.

<u>Revising the lease term</u>

In certain circumstances during the life of a lease, the agency is required to reassess whether it is reasonably certain to exercise or not to exercise an option, and revise the lease team – refer to AASB 16 paragraphs 20-21.

When an agency terminates a lease early, Treasury expects that at some point before the actual termination date, the conditions in paragraph 20-21 would have been met to necessitate a revision of the lease term. This downward revision would adjust the lease liability to reflect the remaining lease payments, and reduce the right-of-use asset and the remaining depreciation period. The result is that there should be minimal (if not zero) right-of-use asset and lease liability balances left on termination date, and no material gains or losses recognised on “disposal” of a lease.

Fixed vs variable rent escalation clauses

Rent escalation clauses that provide for a fixed percentage or dollar increase are included in the initial measurement of the lease liability. Rent escalation clauses that depend on a future index or rate (e.g. consumer price index or market rentals) are considered variable lease payments. AASB 16 requires these variable lease payments that depend on an index or rate to be included in the measurement of the lease liability. However, unlike fixed rent increases, these increases are only included in the liability measurement when there is a change in cash flows. Agencies should not attempt to estimate/predict future variable increases, and instead should assume no change (0% increase) until the future change happens.

For example, if rent increases on 1 July each year following a market rent review, the liability is remeasured on 1 July when the change in rent payments takes effect. At 30 June of the previous year, the lease liability does not take into account this increase or any estimate of future changes yet to be quantified.

Discount rate

The discount rate used to calculate the present value of the lease liability should be the interest rate implicit in the lease, if that rate can be readily determined, or if not, the lessee’s incremental borrowing rate. Calculating the interest rate implicit in the lease requires some information that may only be available to the lessor. Because of this, Treasury’s policy is that if the interest rate implicit in the lease is specified in the lease agreement or otherwise provided by the lessor, agencies should use that rate, otherwise agencies should use their incremental borrowing rate. To determine an incremental borrowing rate:

- Agencies **with** existing loan facilities with QTC should be able to readily ascertain from their loan agreements (or from QTC) what rate they would pay if they were to borrow to obtain an asset of similar value over a similar term.

- Agencies **without** QTC loan facilities should use the Fixed Rate Loan rates that are published monthly on the QTC Link website, selecting the rate that corresponds with the lease commencement date and the lease term. For example, for a 10-year lease commencing 1 September 202X, the agency would use the 10-year Fixed Rate Loan rate at 31 August 202X to as the incremental borrowing rate.

Revising the discount rate

Changes to market interest rates do not automatically necessitate revising the discount rate used to measure the lease liability - only certain circumstances trigger remeasurement of the lease liability under AASB 16 using a revised discount rate, as listed in the table below.

AASB 16 Paragraph	***Situations where lease liability is remeasured with a revised discount rate***
40	There's a change in the lease term, or a change in the assessment of a purchase option
43	There's a change in lease payments that result from a change in floating interest rates
45	The lease is modified, and the modification is not accounted for as a separate lease

QGAO Internal-to-Government Accommodation / QFleet Vehicle Fleet Arrangements

Due to amendments to the governing frameworks and policy documents effective from 1 July 2019, non-specialised commercial office accommodation under the Queensland Government Accommodation Office (QGAO) Office Accommodation Management Framework (OAMF), residential accommodation properties under the Government Employee Housing (GEH) program, and fleet vehicles provided to agencies through QFleet will not meet the definition of a lease under AASB 16.

This is because QGAO/QFleet has substantive substitution rights over the assets provided such that they are considered as the provision of services by the administering department to the user agencies. Accordingly, agencies are not to account for these arrangements as leases and should instead recognise the rental payments as operating expenses when incurred.
Accounting for asset fit-outs under QGAO arrangements

For the avoidance of doubt, office and specialised equipment, such as photocopiers, printers, AV equipment and specialised medical equipment, that are self-funded and controlled by the occupant agency are separate from fit-outs discussed in this section. Such equipment should be capitalised and accounted for by the occupant agency.

For QGAO arrangements that are accounted for as services rather than leases, it is necessary to recognise fit-outs in a manner that ensures whole-of-Government reporting outcomes are properly reflected upon consolidation of agency financial data. Queensland Treasury's expectations for QGAO (and its administering department) and occupant agencies are outlined below:

- QGAO and occupant agencies should continue to recognise, in their own books, any existing fit-outs accounted for under AASB 116 prior to 1 July 2019, and any fit-outs capitalised from 1 July 2019 to 30 June 2022 in line with the applicable FRRs for those financial years.

- A fit-out asset be recorded wholly in the books of one agency to avoid double counting by whole-of-government reporting. Situations where QGAO and the occupant agency each recognises a portion of the asset would ordinarily require 'joint control' to be demonstrated under accounting standards.

- As far as is practical, QGAO should recognise the full amount of new fit-out assets acquired or constructed **except** where:

    - the occupant agency demonstrably controls the fit-out (see guidance below), or

    - the acquisition and construction is undertaken and funded solely by the occupant agency itself, with no involvement from QGAO, in which case the occupant agency may recognise the fit-out asset. This concession is to ensure the asset is appropriately recorded for whole-of-government reporting purposes.

Certain fit-out or improvements in QGAO arrangements may be demonstrably controlled by the occupant agency (rather than QGAO) in circumstances where:

- a fit-out can be economically removed from the premises and moved to a different location or sold, and the occupant agency is permitted to remove the asset and relocate, sell or dispose of it at its discretion, or the occupant agency is required to remove the fit-out before vacating the premises; or

- a fit-out, due to its nature, can only be used by the occupant agency and will have no value to QGAO or another tenant. For example – highly specialised / customised fit-outs, or signage bearing the occupant agency's name or logo.

Where the occupant agency contributes all or part of the costs of a fit-out that is controlled and recognised by QGAO, the occupant agency should expense its contribution as operating expense, with QGAO recognising income.

The guidance in this section is expected to cover the typical fit-out projects and funding scenarios encountered by agencies under QGAO arrangements. Where it is unclear which agency should capitalise the fit-out asset, or if the agency believes an alternative accounting treatment is more appropriate, the occupant agency should consult with QGAO and Queensland Treasury's Accounting Policy Team for accounting advice.

Illustrative Example 1. The occupant agency pays for fit-out costs that will be reimbursed by QGAO from its lease incentives funds. None of the fit-out is demonstrably controlled by the occupant agency.

Accounting Consequence: QGAO should recognise the fit-out asset along with a payable for the reimbursement. The occupant agency records a receivable from QGAO as monies are spent on the fit-outs and reduces the receivable when reimbursement is received. The occupant agency does not recognise any expense or revenue for the fit-out costs that will be reimbursed by QGAO.

Illustrative Example 2A. QGAO installs new fit-outs in the occupant agency's premises and the occupant agency contributes 50% of the cost of the fit-outs. None of the fit-out is demonstrably controlled by the occupant agency.

Accounting Consequence: QGAO should recognise the whole fit-out asset. In respect of the occupant agency's contribution, QGAO recognises income, and the occupant agency recognises operating expense.

Illustrative Example 2B. Same scenario as Example 2A except that 50% of the fit-out is demonstrably controlled by the occupant agency as the fit-out is highly specialised and is permitted to be removed from the premises.

Accounting Consequence: The occupant agency recognises 50% of the overall fit-out representing the specialised fit-out component. QGAO recognises the remaining 50% of the fit-out (i.e. everything except the specialised fit-out).

<u>Leases transferred as part of a Machinery-of-Government change</u>

When a lease arrangement is transferred between agencies in a MoG, the recipient agency takes on the ROU asset and lease liability balances of the transferor. The lease received is not considered a new lease by the recipient. As such, the recipient agency does **<u>not</u>** consider the short-term lease exemption in this situation and must recognise the balances even if the remaining lease term is 12 months or less.

APPLICATION GUIDANCE – LESSORS

Internal-to-Government finance leases

Lessor accounting has not changed significantly under AASB 16, compared to AASB 117. The lessor still classifies leases as operating leases or finance leases, and a finance lease requires derecognition of the underlying asset (which can be a right-of-use asset under a head lease) and recognition of a lease receivable.

From a whole-of-government perspective, the effect of inter-agency leases is eliminated, and the underlying asset must be properly accounted for – including aspects such as depreciation, revaluation and impairment for an item of PP&E. The lessee's accounting for the right-of-use asset can differ significantly from what is required for the underlying asset. For example, the right-of-use asset will be carried at cost, which will differ from the fair value of the underlying asset. In the case of peppercorn leases, such right-of-use assets may be recorded at a nominal amount which will not reflect the fair value of the actual asset controlled by the State.

To permit accurate whole-of-government reporting, Treasury requires that the lessor agency in an internal-to-Government finance lease be responsible for ensuring accurate accounting records are kept for the underlying asset by at least one of the agencies party to the lease. In an arrangement involving multiple internal-to-Government finance leases (e.g. one agency leases the asset to a second agency, who in turn leases it to a third agency), this requirement applies to the head lessor, being the agency that owns the underlying asset or is leasing it from an external party.

Consequently, the lessor agency will need to negotiate with QAO, Treasury and the lessee agency in each situation to agree on the most effective method of properly accounting for the underlying asset. There are a number of ways a lessor agency can approach this, including:

- If permitted by audit, such as on grounds of materiality, the agency may account for the finance lease the same as an operating lease (thus retaining the underlying asset on the lessor's books) and provide additional disclosures to explain the finance lease arrangement. This approach has the benefit of reflecting the whole-of-Government accounting position; or
- maintaining a separate set of records for the underlying asset and report the related transactions and balances in Tridata separately. The disadvantage of this method is there will be a difference between the agency's own statements and their Tridata entries; or
- explore whether a transfer of ownership or accounting control for the underlying asset to the lessee agency can be made – in this case, the lessee agency would then be responsible

for accounting for the underlying asset (which would also reflect the whole-of-Government accounting position); or

- restructure the lease so that it is, in substance, no longer a finance lease (i.e. it is an operating lease).

The lessor agency can also negotiate with the lessee agency to delegate tasks such as accounting or revaluations to the lessee agency, but the lessor agency retains ultimate responsibility.

Classification of subleases

AASB 16 paragraph 58 requires lessors to classify subleases by reference to the right-of-use asset arising from the head lease, rather than by reference to the underlying asset. For example, when assessing whether the lease term is for the major part of the economic life of the asset, the sub-lessor agency would compare the lease term of the sublease with the economic life of its right-of-use asset (being the lease term of the head lease), rather than the economic life of the underlying asset like a building.

Finance leases of a portion of an asset

This section is relevant to lessors (including sub-lessors) who lease out a portion of an asset, such as floor space in an office building or a retail shop within a hospital facility, and the lease of that portion is classified as a finance lease.

Treasury's guidance is that where a material portion of the asset is leased out under a finance lease, the lessor shall derecognise that portion of the asset in line with AASB 16's finance lease accounting requirements. Where the leased portion is not material, the lessor can instead account for it as an operating lease and will not need to derecognise a portion of the asset nor recognise a lease receivable. To estimate the value of the leased portion, agencies can use techniques such as (i) allocating the carrying mount of the whole asset to the leased area based on floor space; or (ii) calculating a market value for the leased area using the rent charged on the lease, where the rent is at a market rate.

Long-term leases of land exceeding 50 years

Although land has an indefinite economic life, transactions involving the long-term lease of land may require classification as a finance lease by the lessor, resulting in derecognition of the land at commencement of the lease. This is because a long-term lease of land is economically similar to a disposal of the land, and at inception of the lease, the present value of the residual value of the property and the lessor's residual risks and rewards after the term of the lease would be insignificant.

Where a long-term lease of land is for a term of 50 years or longer, the lease will ordinarily be expected to meet the AASB 16 classification as a finance lease unless there is compelling evidence to the contrary.

Further, under AASB 16 it is necessary to account for the unguaranteed residual value as part of the net investment in the lease – i.e. the return of the land to the lessor at the end of the lease. In a long-term finance lease, the present value of the unguaranteed residual may not be material until many years (possibly decades) into the life of the lease. Agencies should monitor the unguaranteed residual value and only recognise it when it becomes material and it is established the land will return to the State and the end of the lease term.

AASB 16 Leases - Contract Review Checklist and Data Collection Worksheet

Introduction

Treasury has developed the *AASB 16 Leases Contract Review and Data Collection Worksheet* to assist agencies in reviewing their lease contracts against the requirements of the new leasing Standard.

	Guidance
Is there a lease?	When reviewing contracts, agencies should endeavour to understand and apply the new lease identification requirements and guidance in AASB 16. Even though agencies are not required to reassess this particular aspect on transition, this knowledge will help agencies in the future when re-negotiating leases and entering into new contracts.
Value of the leased asset	If the asset, when new, would normally cost less than $10,000, the agency has a choice of applying the low-value asset exemption and account for the lease similar to current operating lease accounting. Examples of low-value assets include tablets, personal computers, small items of office furniture and phones.
Commencement date	This is the date the underlying asset is made available for use, and usually corresponds with the commencement date as specified in the lease agreement. This is not the date that the lease contract is signed.
Lease term	In addition to the lease term or lease end date stated in the agreement, agencies should also look for any clauses that allow for early termination of the lease and whether there are significant penalties attached. This will allow agencies to accurately determine the non-cancellable period. Any periods beyond the non-cancellable period would need to meet the 'reasonably certain' threshold to be included in the lease term. If the lease term is determined to be 12 months or less, remember to apply the short-term lease exemption.
Lease incentives	Lease incentives are cash payments from the lessor and the lessee's costs assumed or reimbursed by the lessor. Lease incentives to be received in the future are subtracted from the lease payments used to calculate the lease liability. Any rent-free periods should also be reflected directly in the lease payments used to calculate the lease liability. Lease incentives already received by commencement date are subtracted from the initial measurement of the right-of-use asset.

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

The checklist should be read and applied in conjunction with AASB 16 and Queensland Treasury's Financial Reporting Requirements FRR 4B.9.

AASB 16 Leases

Contract Review Checklist and Data Collection Worksheet

Asset code / serial number	
Asset name	
Asset location	
Lessor	

	Check point	Ref	Documentation
1	**Scope – Is there a lease?** *Note: This section should not be used for leases commencing prior to 1 July 2019, as Treasury intends to mandate the practical expedient in paragraph C3.*		

1.1	Determine whether there is an identified asset
	• Consider whether the supplier/lessor have substantive substitution rights
	• Consider if the lease for a portion of the capacity of the asset. If so, assess whether
	  ○ it is a physically distinct portion, or
	  ○ the agency leases substantially all of the capacity of the asset
		B13-B20	

1.2	Assess whether the agency has the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use.	B21-B23	
1.3	Assess whether the agency have the right to direct the use of the asset throughout the period of use. This can be evidenced by: • the agency having the right to direct how and for what purpose the asset is used, OR • the relevant decisions about how and for what purpose the asset is used being predetermined, and cannot be changed by the supplier	B24-B30	
1.4	Conclude whether the contract is, or contains, a lease • If there is no lease, consider what other standard/s would apply to this arrangement • If there is a lease, proceed with this checklist	9 B9-B12	

	Check point	Ref	Documentation
2	**General lease details**		
2.1	Record asset class of the underlying asset	NCAP1	
2.2	Is the lessor external to Queensland Government?		
2.3	Include links to the original lease agreement and any subsequent amendments		
3	**Portfolio application and combination of contracts**		
3.1	If the agency has a portfolio of leases with similar characteristics, consider whether to apply AASB 16 to the portfolio as a whole	B1	
3.2	Consider whether the contract is required to be combined with other contracts and accounted for as a single contract per paragraph B2	B2	
4	**Separating components of a contract**		
4.1	Identify any non-lease components (such as cleaning, repairs, supply of consumables), if any Separate out the lease components and the non-lease components so they can be accounted for separately. However, as per Treasury policy, do not separate out non-lease components for leases of plant and equipment.	12-16 B32-B33	
4.2	Identify any additional lease components included in the lease agreement, e.g. car parks	13	
5	**Exemption for leases of low value assets**		
5.1	Assess whether the leased asset, when new, would cost less than AUD $10,000 If so, decide whether the agency will apply the low value assets exemption to this lease. This decision can be made on a lease-by-lease basis.	5(b) B3-B8	
6	**Lease term**		
6.1	Record the lease commencement date, being the date the underlying asset is made available for use. • This includes any rent-free periods.	Appendix A B36	
6.2	Record the lease end date or expiry date		

	Check point	Ref	Documentation
6.3	Determine the non-cancellable period • Consider whether the agency can terminate the lease at any time without penalty, or can terminate the lease without penalty by giving a certain period of notice • If not, consider whether the agency is locked into the lease agreement for the entire lease term as stated in the lease agreement	18 B34-B35	
6.4	Identify and assess options to extend the lease • Identify extension options beyond the lease term specified in the lease agreement • If there are any, assess whether the agency is reasonably certain (as at the commencement date) to exercise any extension options. For transition purposes, agencies can use hindsight in making this assessment.	18(a) 19 B37-B40 C10(e)	
6.5	Identify and record terms for early termination by the lessee and the lessor	B34-B35	
6.6	Assess the likelihood of early termination by the agency • Consider whether the agency is reasonably certain to lease the asset until the end of the lease term stated in the agreement • If not, estimate the minimum period for which the agency is reasonably certain to lease the asset, taking into account early termination conditions and any penalties attached	18(b) 19 B37-B40	
6.7	After taking into account extension and termination options, decide on the lease term to be used for accounting under AASB 16	18	
6.8	Assess whether the lease term is 12 months or less • If the lease term is 12 months or less, it will be a short-term lease unless there is a purchase option. • Agencies must apply the exemption in para 5(a) for all short-term leases. Note for transition only: If, as at 1 July 2019, the remaining lease term is 12 months or less, it can also be treated as a short-term lease.	5(a) C10(c)	

	Check point	Ref	Documentation
7	**Lease liability measurement**		
7.1	Determine the appropriate discount rate • Is the interest rate implicit in the lease specified in the lease agreement, or otherwise provided by the lessor? • If not, the agency can use their incremental borrowing rate, e.g. QTC fixed rate loan rates appropriate for the lease term and month of commencement. Note for transition only: Agencies must use their incremental borrowing rate at 1 July 2019, and can consider whether to apply a single discount rate for a portfolio of leases with reasonably similar characteristics (e.g. lease term, asset class).	26 C8(a) C10(a)	
7.2	Record details about lease payments and future rent increases provided for in the lease agreement Rent increases may be: • fixed, e.g. 3.5% per year • variable and linked to an index or rate, e.g. CPI, market rent review • a combination of fixed and variable, e.g. CPI plus 2%, higher of CPI and 3.5%, 3% for 5 years followed by a market rent review • specified upfront in a schedule in the lease agreement Also consider any rent-free periods	27(a)-(b) 28 B42	
7.3	Identify any variable lease payments that do not depend on an index or rate, for example payments that will be based on actual usage, output, patronage, etc. • These payments are not included in the measurement of the lease liability, instead they will be accounted for in accordance with para 38(b).	28 38(b)	
7.4	Estimate the future amount payable under residual value guarantees (if any) • This is ordinarily the shortfall between the expected residual value of the asset at the end of the lease and the residual value guarantee.	27(c)	

	Check point	Ref	Documentation
7.5	Assess the likelihood of exercising a purchase option (if any) • Is the agency reasonably certain to exercise the purchase option? • If so, include the purchase payment when calculating the liability, and depreciate the right-of-use asset over the useful life of the underlying asset	27(d) 32	
7.6	If, in determining the lease term, the agency assessed that it is reasonably certain to terminate the lease early and incur a penalty, include the penalty payment when calculating the liability.	27(e)	
8	**Right-of-use asset measurement**		
8.1	Record lease payments made before the commencement date	24(b)	
8.2	Record lease incentives received, e.g. • Cash payment received from the lessor • Reimbursement or assumption by the lessor of costs of the lessee, e.g. removal costs, switching costs, costs of customised enhancements to the leased asset Note: Rent-free periods are taken into account when measuring the lease liability.	24(b) Appendix A	
8.3	Identify initial direct costs incurred by the agency Note for transition only: It is not necessary to identify initial direct costs for leases entered into prior to 1 July 2019.	24(c) C10(d)	
8.4	Estimate the costs of make-good activities required by the lease agreement, e.g. dismantling, removal or restoration to be performed at the end of the lease Consider when does the agency incur the obligation for these costs - e.g. at lease commencement or throughout the lease term.	24(d) 25	
8.5	For not-for-profit agencies, identify whether the lease is a “peppercorn / concessionary lease”, for which additional disclosures are required in para Aus59.1-2. Per Treasury policy, peppercorn leases will be measured initially at cost (para 23-25), similar to other leases.	Aus25.1 Aus59.1 Aus59.2	

	Check point	Ref	Documentation
8.6	For depreciation purposes, identify if ownership of the underlying asset transfers to the agency at the end of the lease term. Also consider step 7.5 above regarding purchase options. If the right-of-use asset is to be depreciated over the useful life of the underlying asset, estimate the useful life of the underlying asset	32	

Lease - Data Collection Worksheet

Asset Name	
Asset Location	
Asset Code	
Asset Class	
Lessor	
Links to agreements (including any amendments)	

Commencement Date	
Expiry Date	
Initial Term	
Lessee Extension Options (details of options, dates and amounts)	
Lessee Termination Options (details of options, dates and amounts)	
Lessor Termination Options (details of options, dates and amounts)	

Discount rate	
Initial Rent	
Lease incentives (eg Rent free or reduced rent period)	
Fixed rent increase description (timeframes, amounts/fixed %)	
Variable lease payments (indexes) (timeframes and method such as CPI)	
Variable lease payments (other) (such as percentage of production)	
Non-lease components (for assets other than Plant and Equipment)	
Existing changes to lease payments (changes that have already occurred)	
Termination payments (purchase options, make-good and residual value guarantee)	
Payments already made (to value right of use asset)	
Initial direct costs (to value right of use asset)	
Other related leases (consideration as to whether to combine)	

FRR 4C Employee Benefit Liabilities

INTRODUCTION

Policy items, indicated by **shaded bold print**, form the Minimum Reporting Requirements (MRRs).

Pursuant to sections 38(2) and 39(2) of the *Financial and Performance Management Standard 2019* (FPMS), departments and statutory bodies must prepare their financial statements in accordance with the MRRs. All of the MRRs are mandatory for departments. Statutory bodies comply with the FPMS by applying the parts of the MRRs that are considered relevant to their circumstances.

Application Guidance, indicated by plain text under the "Application Guidance" sub-headings, provides support on interpreting and applying the mandatory policy items and other matters.

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4C.1 RECOGNITION AND TYPES OF BENEFITS

REFERENCES

- AASB 119 *Employee Benefits*

POLICY

- **An employee benefit liability for accumulated and unused Time Off In Lieu (TOIL) and Rostered Days Off (RDO) leave at reporting date must be recognised when:**
  - **the amount is material when measured on an agency basis; and**
  - **if it is probable that the outstanding TOIL leave will be used by employees before leaving the agency, or if TOIL is paid out on termination.**
- **AASB 119 does not specifically state that elected members are deemed to be employees. However, in the interests of public information, where employee benefits for elected members are material, they must be disclosed as a liability in the financial statements of the relevant agency.**

APPLICATION GUIDANCE

<u>Overall Criteria for Recognition as a Liability</u>

For an employee benefit liability to be recognised, it must be probable that settlement will be required and that the liability can be measured reliably. All entitlements that vest in an employee satisfy the definitions of expenses and liabilities and should be measured and reported. Non-vesting employee benefits may satisfy the definition of expenses or liabilities but they may not meet the recognition criteria as it may not be possible to reliably measure the liability or expense.

Short-term employee benefits (liabilities expected to be wholly settled within 12 months) are to be measured at their nominal value (i.e. undiscounted).

Employee benefits that meet the definition for other long-term employee benefits are to be measured according to most of the requirements for defined benefit plans under AASB 119 except for the requirement for remeasurements of the net defined benefit liability (asset) recognised in other comprehensive income.

Sick Leave

A present obligation in respect of employees' accumulated sick leave entitlements arises only when it is probable that the sick leave to be taken by employees in any future reporting period will be greater than the entitlements that will be accumulated in that future period.

Where experience indicates that, on average, sick leave taken each reporting period is less than or equal to the entitlement accruing in that period and this trend is expected to recur in future periods, it is unlikely that existing accumulated entitlements will be used by employees. Accordingly, no liability for unused sick leave entitlements should be recognised.

As an example, measured on an agency basis, the average period of sick leave taken per employee over the last three reporting periods is five days per year. The average entitlement to sick leave accruing per employee over the same period is 10 days per year. There is no reason to expect that the number of days taken in sick leave will exceed the 10 days per year accruing in future reporting periods and accordingly, no liability should be recognised.

Annual Leave

Agencies that ***are members*** *of the Annual Leave Central Scheme (ALCS)*

Agencies that participate in the ALCS do not recognise a liability for annual leave entitlements in their financial statements since the employer obligation is held by the State. Therefore, generally only the annual leave levy expenses are recognised as employee expenses.

As the agency itself makes the annual leave payments to employees, it will need to claim back these amounts from the ALCS as a reimbursement. Amounts claimed from the scheme but not actually recouped at reporting date are a receivable for the agency.

ALCS policy specifies the on-costs that are to be included in the ALCS levy calculations. On-cost rates are determined by shared service providers (e.g. Queensland Shared Services) in consultation with the agencies that they service and are reviewed on an annual basis.

The guidelines for the ALCS set out the arrangements for dealing with transfers of employees which depend on whether the transferee agency is a member of the scheme. These guidelines are available at: https://www.treasury.qld.gov.au/resource/annual-leave-central-scheme-guidelines/

Generally, the only accounting consequences for member agencies under the ALCS are where cash payments need to be made to the scheme for a higher remuneration rate applicable after commencement of the employee in the transferee agency.

*Agencies that are **not members** of the ALCS*
Employees' annual leave entitlements at reporting date are to be recognised as accrued employee benefit liabilities.

Where payments such as leave loading are payable under an award, they also should be included in the calculation of the related employee benefit liability, where they are not paid out annually.

All directly associated on-costs (e.g. employer superannuation contributions, payroll tax (where applicable) and workers' compensation insurance) should be included where material. For financial reporting purposes agencies may split the employee benefit liability amount between relevant line items such as payroll tax (where applicable) and worker's compensation.

Where the agency's entire liability for annual leave is not expected to be wholly settled within 12 months of the end of the reporting period, it is to be treated as per other long-term employee benefits. On that basis, the liability is to be accounted for, and disclosed, consistent with defined benefit plans (refer to paragraphs 55 – 152 of AASB 119).

Where an agency is not a member of the ALCS, the main accounting consequences for employee transfers is that, to the extent that cash is not transferred, income or expenses are to be recognised in respect of leave entitlements transferred to another agency or acquired from another agency respectively.

Long Service Leave

Agencies that are members of the Long Service Leave Central Scheme (LSLCS)
Agencies that participate in the LSLCS do not recognise a liability for long service leave entitlements in their financial statements as the employer obligation is held by the State. Therefore, generally only the long service leave levy expenses are recognised as employee expenses.

As the agency itself makes the long service leave payments to employees, it will need to claim back these amounts from the LSLCS as a reimbursement. Amounts claimed from the scheme, but not actually recouped at reporting date, are a receivable for the agency.

The guidelines for the LSLCS set out the arrangements for dealing with transfers of employees, which depend on whether the transferee agency is a member of the scheme.

These guidelines are available at:
https://www.treasury.qld.gov.au/resource/long-service-leave-central-scheme-guidelines/

Generally, the only accounting consequences for member agencies under the LSLCS are where a transferred employee previously earned long service leave entitlements at an entity that is not party to the reciprocal leave recognition arrangements outlined in the Queensland Government Awards page (https://www.qirc.qld.gov.au/awards) and the agency chooses to recognise those long service leave entitlements on commencement. In this situation, a cash payment would be made to the LSLCS.

Agencies that are not members of the LSLCS

Generally, agencies which are not part of the LSLCS manage their own leave balances. The following entitlement categories of long service leave are common:

(a) An 'unconditional' legal entitlement to payment arises after a qualifying period of service (e.g. 10 years). Accumulation of long service leave entitlement continues after this point until the leave is taken.

(b) A 'conditional' entitlement exists in certain circumstances (e.g. death, retrenchment, or early retirement under some awards) and a legal entitlement to pro rata payment in lieu of long service leave arises (sometimes only after a qualifying period of service).

(c) Under a 'pre-conditional' entitlement, no legal entitlement to any payment or leave exists before the accumulation of the period of service necessary to qualify for the entitlement described in (a) or (b) above.

In the Queensland public sector there are generally only two categories of long service leave, being an unconditional entitlement and pre-conditional entitlement. However, in some special circumstances (as set out in Public Sector Commission directives) a pro-rata payment may be made to a Queensland public sector employee.

Agencies that are not members of the LSLCS should generally treat their long service leave obligations as other long-term employee benefits. On that basis, they are to be accounted for, and disclosed, consistent with defined benefit plans (refer to paragraphs 55 – 152 of AASB 119).

Where an agency is **not** a member of the LSLCS, the main accounting consequences for employee transfers is that, to the extent that cash is not transferred, income or expenses are to be recognised in respect of leave entitlements transferred to another agency or acquired from another agency respectively.

Superannuation

Queensland Treasury's distinction between the two types of superannuation plans is as follows:

- Defined contribution plans – the State's obligation is limited to the amount that it agrees to contribute to the plan. As a result, superannuation entitlement risk (that benefits will be less than expected) and investment risk (that returns on assets invested will be insufficient to ultimately meet expected benefits) fall on the employee.

- Defined benefit plans – the State's obligation is to provide the agreed benefits to current and former employees, resulting in superannuation entitlement risk (that benefits will cost more than expected) and investment risk falling on the State. If superannuation entitlements are greater than expected or investment returns are worse than expected, the State will cover any shortfall.

Defined ***Contribution*** *Plans – No actuarial assumptions*

The accounting and recognition for defined contribution plans is straightforward as the State's obligation for each period is limited to the amounts to be contributed for that period. No actuarial assumptions are required to measure the obligation or the expense, and no actuarial gain or loss arises.

As an employee renders service, agencies must recognise the contributions payable to the superannuation plan:

- as a liability (accrued expense) after deducting any contributions already paid. If the contributions already paid exceeds the contributions due, an agency shall recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to a reduction in future payments or a cash refund; and

- as an expense, unless an accounting standard requires or permits the inclusion of the contribution in the cost of an asset e.g. capitalised into the cost of a non-current asset under AASB 116 Property, Plant and Equipment.

AASB 119 contains the recognition, measurement and disclosure requirements for defined contribution plans.

Defined ***Benefit*** *Plans (Agencies contributing to the Government Division of Australian Retirement Trust)*

For agencies that contribute to the Government Division defined benefit categories administered by Australian Retirement Trust (the former QSuper defined benefit categories), the employer liability is held by the State (consistent with the ALCS and LSLCS). Hence, no liability for superannuation benefits should be recognised in such agencies' financial statements, except for contributions due and unpaid at balance date.

Defined ***Benefit*** *Plans (Agencies not contributing to the Government Division of Australian Retirement Trust)*

The accounting and recognition for defined benefit plans is more complex. The ultimate cost to the employer of a defined benefit plan may be influenced by many variables such as final salaries, employee turnover, mortality and the investment earnings on the plan assets.

In order to measure the obligation and the related current service cost it is necessary to:

- determine the deficit or surplus - which involves using a particular actuarial technique to estimate the cost of the employee benefits earned by employees, discounting that benefit in order to determine the present value of the employer obligation and current service cost, and deducting the fair value of plan assets from the present value of the employer obligation;

- determine the amount of the net defined benefit liability (asset);

- determine various amounts to be recognised in the operating result; and

- determine the re-measurements of the net defined benefit liability (asset) to be recognised in other comprehensive income.

Paragraphs 55-152 of AASB 119 contain the detailed requirements regarding the accounting for, and disclosure of, defined benefit plans.

It will be necessary for agencies to engage an actuary to determine an agency's superannuation liability. Agencies should refer to AASB 119 for details about calculation and disclosure requirements. Interpretation 14 *AASB 119 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* should also be referred to for guidance on:

- how to assess the limit in AASB 119 on the amount of a surplus that can be recognised as an asset by an employer sponsor to a defined benefit plan;
- how a defined benefit surplus/deficiency recognised by an employer sponsor may be impacted by a statutory or contractual minimum funding requirement;
- when refunds or reductions in future contributions should be regarded as available under AASB 119;
- how a minimum funding requirement might affect availability of reductions in future contributions; and
- when a minimum funding requirement might give rise to a liability.

Other Post-Employment Benefits

These benefits should not apply to most agencies. When they are payable, a liability must be recognised:

- progressively over the reporting periods up to the time when the benefits become vested after a specified qualifying period; and
- in the reporting period an employee is appointed to a specific position where the benefits vest at the time of appointment.

Examples of post-employment benefits include the provision of free or subsidised non-monetary benefits after the completion of employment, such as air or train travel, office accommodation, administrative support and the use of a motor vehicle.

The measurement of a post-employment benefit liability should take into account the probability that some employees will not attain the requisite years of service entitling them to part or all of the benefits.

Termination Benefits

There may be uncertainty regarding the agency's plans regarding terminations or number of employees who will accept an offer of termination benefits. When this uncertainty exists, a liability should not be recognised. Instead, a contingent liability should be disclosed, unless the possibility of termination benefits resulting is remote, in which case, there should be no disclosure. Reference should be made to paragraphs 159-170 of AASB 119 for the requirements for the recognition and measurement of termination benefit liabilities.

4C.2 CURRENT / NON-CURRENT SPLIT

REFERENCES

- AASB 101 *Presentation of Financial Statements*
- AASB 119 *Employee Benefits*

APPLICATION GUIDANCE

Distinguishing between current and non-current employee liabilities

For presentation and disclosure purposes under AASB 101, agencies must distinguish current employee benefit liabilities from non-current employee benefit liabilities – this applies to all employee benefits, including performance payments and termination benefits.

Measurement under AASB 119 not affected by AASB 101 presentation

The fact that a class of employee benefit liability (other than short-term employee benefits) may be split into current and non-current components under AASB 101 does not affect how the entire class of benefit is to be measured under AASB 119 (e.g. as an 'other long-term employee benefit'). Agencies should therefore ensure employee benefit liabilities are correctly classified and measured under AASB 119 principles before determining the current / non-current split under AASB 101.

AASB 101 specifies that a liability is classified as current where the entity does not have the right at the end of the reporting period to defer settlement of a liability for at least twelve months after the reporting period; or the liability is due to be settled within twelve months after the end of the reporting period. Consequently:

- any class of employee benefit that meets the definition of "short-term employee benefits" in AASB 119 is a current liability under AASB 101; and
-
- any class of employee benefit under AASB 119 (other than short-term employee benefits) will be a current liability where either of the two AASB 101 conditions (refer above) are met. (For example, annual leave liability obligations outside the ALCS measured as "other long term benefits" as discussed in the guidance to FRR 4C.1.)

FRR 4D Liabilities, Contingencies and Commitments

INTRODUCTION

Policy items, indicated by **shaded bold print**, form the Minimum Reporting Requirements (MRRs).

Pursuant to sections 38(2) and 39(2) of the *Financial and Performance Management Standard 2019* (FPMS), departments and statutory bodies must prepare their financial statements in accordance with the MRRs. All of the MRRs are mandatory for departments. Statutory bodies comply with the FPMS by applying the parts of the MRRs that are considered relevant to their circumstances.

Application Guidance, indicated by plain text under the "Application Guidance" sub-headings, provides support on interpreting and applying the mandatory policy items and other matters.

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4D.1 DISTINCTION BETWEEN COMMITMENTS, LIABILITIES AND CONTINGENT LIABILITIES

REFERENCES

- *Framework for the Preparation and Presentation of Financial Statements*
- AASB 101 *Presentation of Financial Statements*
- AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*
- Interpretation 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*

APPLICATION GUIDANCE

Essential criteria for a liability to exist

An essential characteristic of a liability is that the agency has a present obligation to an external party. The identity of the external party need not be known. The obligation could be to the public at large. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract (for example, with amounts payable for goods and services received) or arise from a statutory requirement.

A liability must be associated with a past event/transaction that gives rise to a present obligation that will result in an outflow from the agency of resources embodying economic benefits. The transaction or event must have occurred.

In most cases, the outflow will be in the form of cash. Settlement of the obligation represented by the liability may also occur in other ways, for example, the transfer of other assets, the provision of services, the replacement of that obligation with another obligation; and conversion of the obligation to equity.

The criteria for recognition will not be affected if the future outflow of economic benefits will be subject to estimation to any degree e.g. a class claim for compensation.

In determining end-of-period accruals, an appropriate materiality level should be set below which accruals need not be recognised.

Allowances for impaired debts, depreciation and impairment are not liabilities or provisions within the definition of a liability under AASB 137. These are treated as a reduction of the relevant asset class.

Distinction between Commitments and Liabilities

Commitments do not give rise to present obligations

Commitments and liabilities arise at separate timing points. Therefore, a key issue is identifying the point at which a commitment becomes a liability. This is important as the recognition of a liability requires the concurrent recognition of an expense or an asset or the reduction of equity. A commitment is not accompanied by a present obligation e.g. merely ordering goods or services would give rise to a commitment but not a present obligation to make a payment. Similarly, a decision by the management of an agency to acquire assets in the future does not, of itself, give rise to a present obligation.

Agreement to commit to a future outflow of resources; but no present obligation

The term 'commitments' is not defined in any accounting standard. Generally, a commitment arises when an entity enters into an agreement with an external party that will result in a future obligation to make an outflow of resources.

Unrecognised contractual commitments

Such agreement would usually be in the form of a purchase order or other contractual documentation. A contractual commitment would be accompanied by, but not limited to, actions taken to determine the amount of the eventual resource outflow or a reliable estimate (e.g. a quote), and confirmation/agreement of conditions to be satisfied to establish an obligation (e.g. delivery schedules).

Budgeting alone not sufficient

These preconditions ensure that the information relating to commitments is relevant and capable of reliable measurement. Without such an agreement a commitment would generally not exist. By way of example, the mere setting aside a portion of a budget for particular expenditure would not be sufficient to constitute a commitment.

In contrast, an agency may enter into a contract before the reporting date for expenditure over subsequent reporting periods, such as a contract for construction of infrastructure, major plant and equipment, or a significant consultancy contract. Even though work has not commenced, and no payments have been made, in this situation, a commitment exists at the reporting date.

A commitment becomes a liability when agreement becomes a present obligation

A commitment becomes a liability when the agreement becomes a present obligation. A present obligation would generally exist if it is probable that the other party would succeed in an action to secure payment or be awarded significant compensation in the event of non-payment i.e. there is little or no discretion to avoid an outlay of funds for work already undertaken, or goods delivered/services provided, by the other party. An irrevocable agreement to acquire goods/services/assets would normally give rise to a present obligation.

Examples of a commitment becoming a liability include when construction of an asset has already commenced, new equipment ordered is received, office supplies ordered are delivered, telecommunication services are invoiced, or external consultants have commenced undertaking their work.

Examples of transaction cycles that may assist in distinguishing between commitments and liabilities are as follows:

Placing a contract out to tender

Stage ---------->	**Decision to put the contract out to tender**	**Tender called**	**Contract accepted and signed**	**Contract work commenced**	**Contract work completed**	**Payment made**
Classification --->	No recognition/ No disclosure	No recognition/ No disclosure	Commitment	Liability for work performed. Commitment for unperformed portion	Liability	Liability extinguished

Ordering office furniture or equipment

Stage ----------->	**Need identified**	**Quotes obtained**	**Order placed**	**Order accepted**	**Goods delivered / accepted**	**Payment made**
Classification --->	No recognition/ No disclosure	No recognition/ No disclosure	Commitment	Commitment	Liability	Liability extinguished

Payment of Grants

Stage ----------->	**Conditions set by Government**	**Application received**	**Applicant (now 'grantee') advised of success of application**	**Criteria met by 'grantee' for payment of funds**	**Payment made**
Classification --->	No recognition/ No disclosure	No recognition/ No disclosure	Commitment	Liability	Liability extinguished

Provisions are a Category of Liability

Provisions are a category of liabilities for which the amount or timing of the future outflow is uncertain e.g. provisions for rehabilitation. A provision is recognised as a liability under AASB 137 when, and only when:

- the agency has a present obligation (legal, equitable or constructive) to a third party as a result of a past event;
- it is probable that an outflow of resources will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.

If there is any doubt as to whether a present obligation exists, a contingent liability rather than a provision should be disclosed.

Liabilities can only be recognised in respect of past events. Therefore, provisions cannot be created in respect of costs that will need to be incurred to operate in the future. Paragraphs Aus26.1 and Aus26.2 of AASB 137 provide additional guidance on potential liabilities arising from existing Governments' public policies, budget policies, election promises or statements of intent.

Distinction between Contingent Liability and Liability

Contingent liabilities are differentiated from provisions, and therefore liabilities, on the criteria of probability. With a contingent liability, a possibility rather than a probability will exist with respect to the future commitment to the outflow from the entity of resources embodying economic benefits.

Contingent liabilities are disclosed in the notes to the financial statements - they are not recognised as a liability in the Statement of Financial Position. However, a contingent liability may progress to become a provision and require measurement as a liability, even where a degree of uncertainty remains over the amount or timing of the amount to be settled. For example, when a lawsuit is commenced against an agency, a contingent liability will likely exist. If, at balance date, the decision has gone against the agency, but the amount to be paid or the time by which the amount has to be paid is the subject of some uncertainty, the agency must still recognise a provision for the best estimate of the expenditure required to settle the provision at the balance date.

4D.2 ADJUSTING LIABILITIES FOR EVENTS AFTER REPORTING DATE

REFERENCES

- AASB 110 *Events after the Reporting Period*

APPLICATION GUIDANCE

Where an adjusting event occurs that affects a liability that has been disclosed, for example, the amount or timing of a liability has altered or an uncertainty relating to a provision has been removed, then an adjustment to that item is required. Where a future obligation relating to a contingent liability has been confirmed (e.g. a court case is settled after the reporting date and the contingency has previously been disclosed in a note), then a liability or provision will need to be recognised as a provision (even if some uncertainty still exists with respect to the amount or timing of the discharge of the obligation), or as a payable if no uncertainties exist.

Where a non-adjusting event occurs relating to liabilities, for example, the market value of a financial liability changes after the reporting date, no adjustments are made to the financial statements. However, if a non-adjusting event after the reporting date is material, the agency must disclose the nature of the event and an estimate of its financial effect (or a statement that such an estimate cannot be made) for each material category of non-adjusting event.

4D.3 CHANGES IN LONG-TERM PROVISIONS OVER MULTIPLE REPORTING PERIODS AND DATES

REFERENCES

- AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*
- Interpretation 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*

APPLICATION GUIDANCE

Changes in Provisions

It is not uncommon for the amount estimated to settle a long term provision to vary between reporting periods, and reporting dates, until the specified time of settlement.

In respect of the reviewing provisions at each reporting date, paragraph 60 of AASB 137 provides that where discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time. This increase is recognised as a borrowing expense.

For example, assume a present obligation is likely to be settled in 5 years' time at an estimated amount of $100,000. The provision is recognised at its present value. The Australian Government bond rate for a 5 year period at that time is 5%, so this rate is used as the discount rate. The discount factor of 5% for five years is 0.784. Therefore, the present value of $100,000 on initial recognition will be $100,000 x 0.784 i.e. $78,400.

One year later, expected settlement of the provision will only be four years later. The discount factor of 5% for four years is 0.823. The present value of $100,000 one year after initial recognition will be $100,000 x 0.823 i.e. $82,300.

In terms of paragraph 60 of AASB 137, the difference between the two present values i.e. $3,900 is recognised as a borrowing expense.

Journal entries would be as follows:

Initial recognition (reporting period one)

Expense	Dr	78,400		
(classified according to the nature of underlying transaction)				
Provision			Cr	78,400
(Creation of provision: Present Value of $100,000 in 5 years @ 5%)				

One year later (reporting period two)

Borrowing Expense	Dr	3,900		
Provision			Cr	3,900

(Borrowing expense: difference between Present Value of $100,000 @ 5% in 5 years' time vs 4 years' time)

It is unlikely that the discount rate will remain constant over the life of the provision until the time of ultimate settlement. Paragraph 84 of AASB 137 requires a reconciliation to be provided for each class of provision, reconciling the closing carrying amount with the opening carrying amount. One of the elements of the reconciliation is the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.

In the example above, if the bond rate had increased to 6% at the end of the second reporting period, then the discount factor for 4 years @ 6% would be 0.792. The net present value of $100,000 would be $100,000 x 0.792 i.e. $79,200. Accordingly, the increase in provision and borrowing expense would be $800 (i.e. $79,200 minus the initially recognised $78,400) and this amount would be disclosed in the reconciliation as required by paragraph 84 of AASB 137.

Reimbursement of Expenditure to Settle a Provision

Paragraph 53 of AASB 137 provides that where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement is to be recognised when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation.

Dismantling, Removing and Restoring Items of Property, Plant and Equipment

Under AASB 116, where an obligation exists to dismantle and remove an asset or restore the site on which it is located, the cost of the item includes the initial estimate of these costs. An agency incurs this obligation, which may be a legal, contractual or social obligation, either when an item is acquired or as a consequence of having used the item during a particular period for purposes (other than to produce inventories.)

AASB 137 contains requirements on how to measure provisions for decommissioning and restoration of items.
Where the cost of the asset includes the initial estimate of these restoration costs, Interpretation 1 addresses how the effect of the following events that change the measurement of existing decommissioning, restoration or similar liability should be accounted for:

- a change in the estimated outflow of resources embodying economic benefits (e.g. cash flow) required to settle the obligation;
- a change in the current market-based discount rate as defined in paragraph 47 of AASB 137; and
- an increase that reflects the passage of time (also referred to as the unwinding of the discount).

Interpretation 1 applies irrespective of whether the related asset is measured using the cost model or the revaluation model.

Disclosing key assumptions and other sources of estimation uncertainty
AASB 101 paragraph 125 provides that an agency is to disclose in the notes information about the assumptions concerning the future, and other major sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of liabilities within the next annual reporting period. In respect of those liabilities, the notes to the accounts are to include details of their nature and carrying amount as at the end of the reporting period.

Some liabilities e.g. retirement benefit schemes, can only be measured using a substantial degree of estimation e.g. return on fund assets and by making assumptions about future events e.g. movements in interest rates. Should these estimates and/or assumptions prove to be incorrect, then the carrying amount of the liability will be misstated and the liability will either be overstated or understated.

The risks associated with the misstatement increases significantly the more complex and subjective the assumptions and estimates are.

Materiality is a key issue in the application of this disclosure requirement, which has as its focus, liabilities with large carrying amounts and with a high risk of material misstatement should the underlying estimates and assumptions prove to be incorrect.

Agencies with substantial liabilities that have been measured on the basis of complex and/or subjective assumptions and estimates should apply a risk analysis to them. Where there is a high risk of those assumptions and estimates being subject to error or inaccuracy, the agency should assess the impact on the associated liability if the risk was to materialise and disclose the outcome.

Where it is impractical to disclose the extent of the possible effects of changes to the underlying assumptions and estimates made, the agency should disclose that fact and also state that outflows within the next reporting period may be different due to variations to the assumptions made and that this could require a material adjustment to the carrying amount of the liability in future reporting periods.

Liabilities that are measured at fair value at the reporting date are not included in the abovementioned risk group if they are measured at fair value based on recently observed market prices. Such fair values might change materially but these changes would not arise from assumptions or other sources of estimation uncertainty. Disclosure of significant assumptions made in estimating the fair value of financial liabilities that are carried at fair value is covered by AASB 13.

Uncertainties

Agencies are required to disclose uncertainties with regard to each class of provision according to the criteria set out in paragraph 85 of AASB 137. For example, if the government acknowledged that it had an obligation to rectify land degradation and identified an amount that it was prepared to pay, a provision would be created.

The government may be satisfied that, in terms of Commonwealth Government policy, this was an issue of national importance and funding from that level of government was likely. Such anticipated funding would be taken into account in establishing the provision.

4D.4 DISCLOSURE REQUIREMENTS FOR COMMITMENTS

REFERENCES

- AASB 101 *Presentation of Financial Statements*
- AASB 116 *Property Plant and Equipment*
- AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*
- AASB 138 *Intangible Assets*
- AASB 140 *Investment Properties*

POLICY

- **Commitments required to be disclosed by applicable accounting standards must be shown in total for each class of commitment in the following time bands according to the time that is expected to elapse from the reporting date to their expected date of settlement:**
  - **Within twelve months**
  - **twelve months or longer and not longer than five years; and**
  - **longer than five years**
- **The value of commitments disclosed must be inclusive of any GST that will not be recouped by the agency.**

FRR 4E Financial Instruments

INTRODUCTION

Policy items, indicated by **shaded bold print**, form the Minimum Reporting Requirements (MRRs).

Pursuant to sections 38(2) and 39(2) of the *Financial and Performance Management Standard 2019* (FPMS), departments and statutory bodies must prepare their financial statements in accordance with the MRRs. All of the MRRs are mandatory for departments. Statutory bodies comply with the FPMS by applying the parts of the MRRs that are considered relevant to their circumstances.

Application Guidance, indicated by plain text under the "Application Guidance" sub-headings, provides support on interpreting and applying the mandatory policy items and other matters.

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4E.1 FINANCIAL INSTRUMENTS – CLASSIFICATION AND MEASUREMENT

REFERENCES

- AASB 7 *Financial Instruments: Disclosures*
- *AASB 9 Financial Instruments*
- AASB 13 *Fair Value Measurement*
- AASB 101 *Presentation of Financial Statements*
- AASB 132 *Financial Instruments: Presentation*
- Interpretation 16 *Hedges of a Net Investment in a Foreign Operation*

APPLICATION GUIDANCE

A financial instrument is defined in AASB 132, and include items such as cash, trade receivables and payables, loans, bonds, equity investments, derivatives, and others. Some items like prepayments and unearned revenue are not financial instruments because they are settled by receipt/delivery of goods or services rather than with cash or another financial asset.

The initial recognition and measurement requirements of AASB 9 do apply to statutory receivables (but not statutory payables). Otherwise, agencies should take note of the types of financial instruments excluded from the scope of the three standards – AASB 7, AASB 9 and AASB 132. Exclusions include interests in subsidiaries, associates and joint ventures, employee benefits, insurance contracts, amongst others.

Statutory receivables are deemed financial assets under AASB 9

AASB 9 Appendix C contains guidance about statutory receivables, specifically on the timing of recognition. An agency recognises a statutory receivable and corresponding revenue when the statutory requirements establishes a right for the agency to receive cash or another financial asset. Such a right arises on the occurrence of a past event, for example:

- Land tax – passing of the relevant land tax assessment time/date;
- Fines and penalties – when the fine is issued;
- Payroll tax – end of each payroll tax return period;
- Transfer duty – date of dutiable transfer.

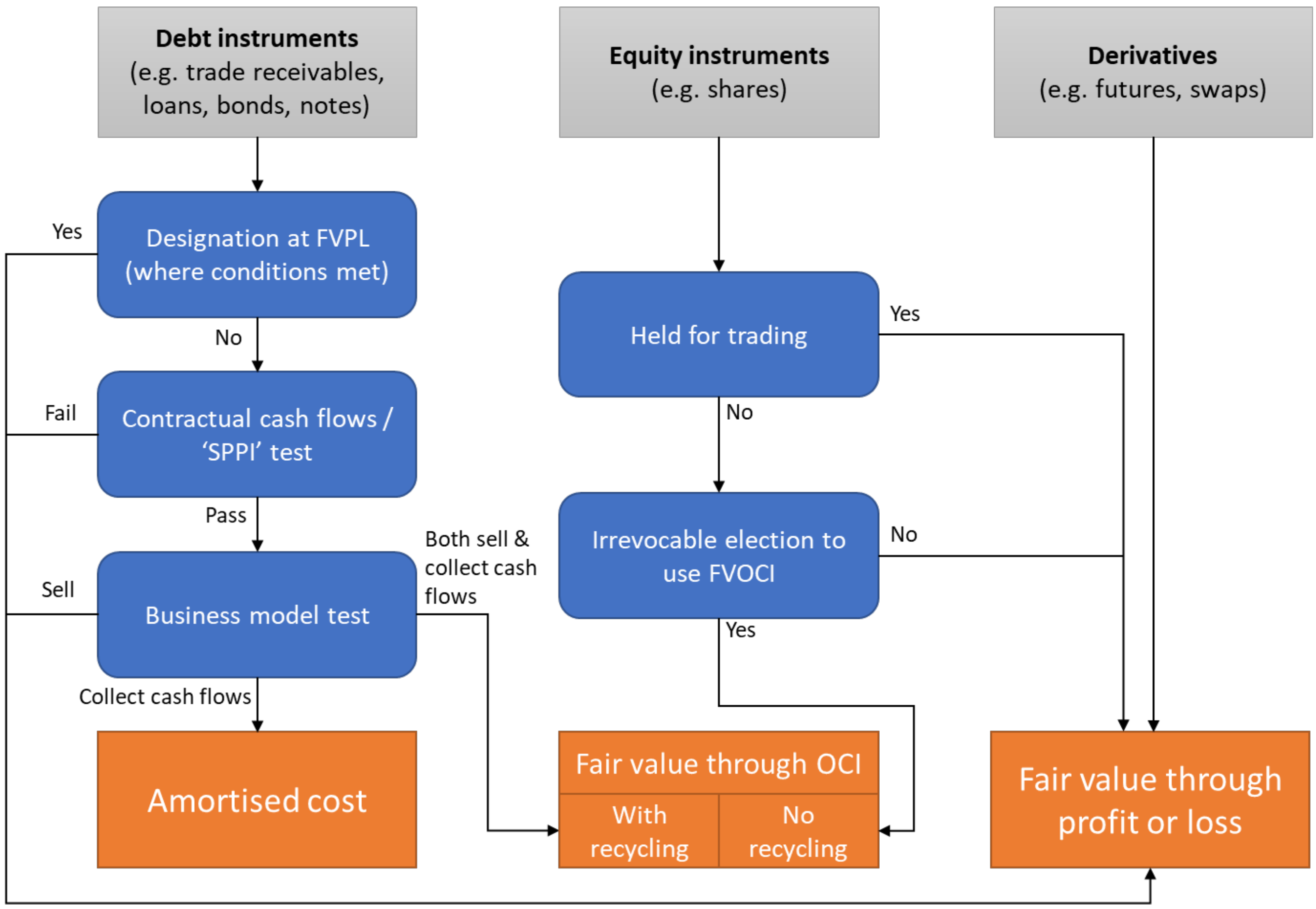
Paragraph C7 states that in some instances the receivable arising from taxable events cannot be measured reliably until a later reporting period. For example, in rare circumstances, the amount may not be measurable until all the relevant information has been produced and certified. In such cases, the receivable (and revenue) would only be recognised once the amount can be measured reliably. However, if the amount of the revenue is capable of estimation but will not billed/levied until after year-end, an accrual of revenue may be required at the reporting date.

Agencies are also to use the impairment principles of AASB 9 to calculate the loss allowance for statutory receivables. FRR 4E.2 discusses impairment in more detail. For departments, statutory receivables and revenue will also need to be properly classified into controlled and administered items in accordance with FRR 2E.

Classification of financial assets

Financial assets are classified into one of three underlying measurement bases – amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVPL). The classification criteria are outlined in the following flowchart:

Financial assets classification under AASB 9



However, within the FVOCI category, debt instruments and equity instruments have differing accounting treatments, summarised in the following table:

Table: Accounting Treatment for Debt and Equity Instruments at FVOCI

	Debt instruments at FVOCI (para 4.1.2A)	**Equity instruments at FVOCI** (para 5.7.5)
Recycling of fair value gains or losses to P/L when the asset is derecognised	Recycling	No recycling
Effective interest method	Applies	Not applicable
Impairment	Applies	Not applicable

<u>Key tests for measuring financial asset debt instruments</u>

For debt instruments, such as trade receivables and loans receivables, that are not designated at FVPL by the entity, there are <u>*two key tests*</u> to be applied to determine the correct measurement basis.

1. The **contractual cash flows test (“SPPI test”)**.

This test assesses whether the contractual terms of the financial asset give rise on specific dates to cash flows that are ***solely payments of principal and interest*** (SPPI) on the principal amount outstanding. For the purposes of considering whether interest meets this test, the most significant elements of interest within a basic lending arrangement are typically the consideration for the time value of money and credit risk. Consideration may also include compensation for other basic lending risks (e.g. administrative costs).

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

2. The **business model test.**

This test assesses the objective of the business model within which the financial asset is held to determine the classification of financial assets that meet the contractual cash flows test.

- If the business model objective is to hold financial assets in order to ***collect contractual cash flows***, and the SPPI test is met, the financial asset is measured at amortised cost.

- If the business model objective is achieved by both ***collecting contractual cash flows and selling financial assets***, and the SPPI test is met, the financial asset is measured at FVOCI.

Gains and losses recognised in OCI are reclassified ('recycled') to profit or loss upon derecognition.

- If another business model objective is used (i.e. a business model other than the two specified above) the financial asset is measured at FVPL. An example of this is where the business model objective is the realisation of cash flows through the sale of financial assets.

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

Concessional interest and interest-free loans

These loans are often provided with the intent of providing a benefit (the concessional component) to the borrower. When initially measuring the loan receivable at fair value, the agency should use an observable market interest rate for a loan of a similar amount, duration and security. For example:

- if the loan is secured by real estate, the agency can look at prevailing mortgage rates,
- if the loan is to an individual and is unsecured, the agency can look at unsecured personal loan rates.

As the market rate is higher than the concessional rate offered in the loan, the loan's initial fair value will be less than the cash advanced. The difference is to be recognised as an expense in accordance with paragraphs 5.1.1A and B5.1.2A, and it will typically be classified as a grant expense. With the concessional component separated out as an expense, the remaining financial asset will likely meet the criteria for amortised cost.

Originated credit-impaired loans

A concessionary loan (or portfolio of loans) may, in certain instances, have the same or similar characteristics to a originated credit-impaired loan. E.g. issuing loans to a sector of the economy or community facing hardship where it is expected, at the outset, that not all borrowers will be able to repay all of their commitments. In such cases, the finance provided may be an in-substance grant provided to the borrower and the entire difference between the loan's fair value and the cash advanced should be treated as a grant expense on initial recognition, rather than as a credit loss.

Originated credit-impaired loans have different interest revenue recognition requirements – refer to paragraphs 5.4.1(a) and B5.4.7. Where such loans are measured subsequently at amortised cost, repayments of principal that exceed the initial fair value measurement of the loan would be credited to the operating statement as an impairment gain (paragraph 5.5.14).

Contingently Repayable Loans

Agencies need to consider the contractual conditions that determine or trigger the contingent payments. Where there is exposure to risks/variables other than those expected in a basic lending arrangement (time value of money and credit risk), the loan is unlikely to meet the SPPI test, and will therefore be measured at FVPL.

For example, if a loan is repayable upon the borrower company achieving financial success with a product, then it is contingent on a variable other than time value of money or credit risk. The loan will therefore need to be measured at FVPL.

Unquoted equity instruments

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

Agencies are permitted to make the election in AASB 9 paragraph 5.7.5 to measure equity instruments that are not held for trading at FVOCI instead of FVPL. Unlike debt instruments measured at FVOCI, the gains and losses recognised in OCI are not reclassified/recycled to profit or loss when the equity instrument is derecognised. Also, agencies should note that additional disclosures are required for equity instruments held at FVOCI.

4E.2 FINANCIAL INSTRUMENTS – IMPAIRMENT

REFERENCES

- *AASB 9 Financial Instruments*
- AASB 101 *Presentation of Financial Statements*

POLICY

- **Agencies shall use the simplified approach in AASB 9 paragraph 5.5.15 (and therefore always measure lifetime expected credit losses) for all trade receivables and contract assets, including those that contain a significant financing component.**

- **Agencies shall not use the simplified approach in AASB 9 paragraph 5.5.15 for lease receivables.**

- **Departments and statutory bodies consolidated into the whole-of-Government financial statements shall not recognise a loss allowance under AASB 9 for receivables from another Queensland Government agency (including Government-owned Corporations) unless approval has been received from Queensland Treasury.**

APPLICATION GUIDANCE

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

In addition to financial assets, there are certain assets that do not meet the definition of a financial instrument but to which AASB 9 impairment requirements apply (e.g. contract assets arising from AASB 15).

Impairment of inter-agency receivables

Inter-agency loans and receivables between Departments, Statutory Bodies and Government Owned Corporations are expected to have an insignificant, and therefore immaterial, level of credit risk exposure due to the high credit rating of the State. This conclusion is based upon the historical default rates published by global credit rating agencies periodically (and monitored by Queensland Treasury) relating to the credit rated sovereign debt on issue globally.

Consequently, Queensland Treasury expects that departments and statutory bodies will not measure any loss allowance for receivables collectible from other Queensland Government agencies on the basis that any impairment would be negligible, and therefore immaterial. Agencies are to consult with Treasury before recognising an impairment loss on any inter-agency receivable.

Agencies are responsible for ensuring that internal-to-Government receivables/payables are properly recorded in BOTH AGENCIES financial records for the purpose of accurate elimination for whole-of-Government reporting. There may, from time to time, be disputes around the validity or legitimacy of inter-agency receivables. This might range from whether a debt is owed at all to the amount of the receivable/payable. In these situations, Queensland Treasury does not consider this requires an impairment loss to be recognised within a whole-of-Government context – rather the agencies shall resolve the dispute so the receivable / payable position between the two agencies agrees.

The resolution of the issue may result in the "lending" agency either de-recognising or writing down the carrying amount of the receivable. The adjustment may also involve the full or partial reversal of the original entry recorded. Alternatively, the "borrowing" agency may need to recognise an additional amount payable or settle the outstanding debt owing. The agencies involved should consult with their Treasury Analyst if required to resolve the matter.

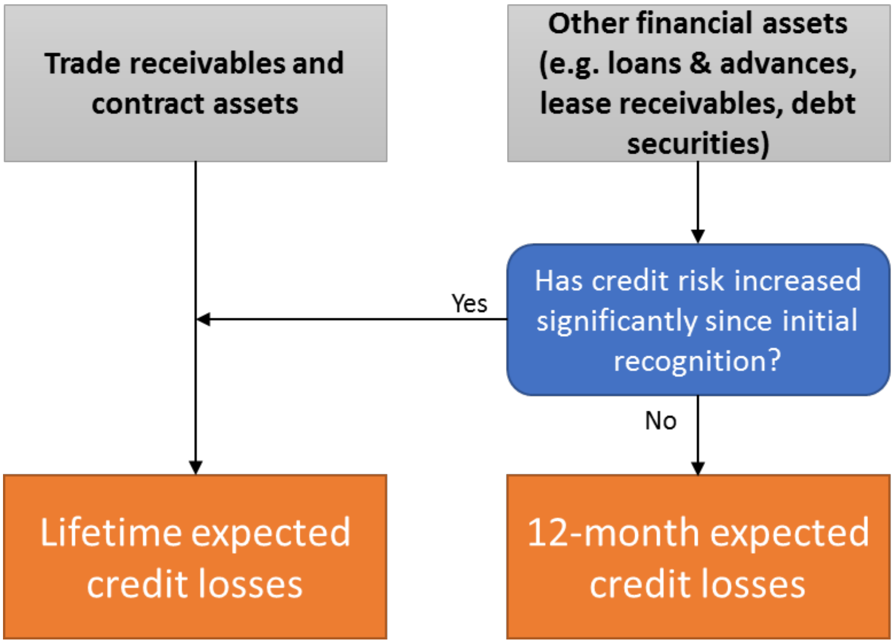
Expected credit losses

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

A key change from AASB 139 is the requirement to consider forward-looking information that is available without undue cost or effort. Agencies will need to apply significant judgement about how expected future changes in macroeconomic factors (e.g. economic growth, unemployment, household debt levels, etc.) will affect their measurement of expected credit losses. For this purpose, economic statistics published by the Queensland Government Statistician's Office may provide a useful basis for making forward looking estimates/judgements.
https://www.qgso.qld.gov.au/statistics/theme/economy/labour-employment/state

Using the QGSO statistics, agencies can perform trend analysis and/or correlate the information against actual defaults experienced by agencies. Known events or conditions pertaining to a specific group of debtors or geographic area must also be taken into account.

The impairment allowance for financial assets is measured at either '12-month expected credit losses' or 'lifetime expected credit losses' summarised in the flowchart below:



Estimating expected credit losses for trade receivables

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

The most practical method to calculate expected credit losses for trade receivables will depend on the nature of the agency's portfolio of debtors. Any agency with a small number of debtors may find it more efficient to assess each debtor individually – refer to Example 1 below. Alternatively, agencies with large portfolios can use a provision matrix as a practical expedient – refer to Examples 2 and 3 below.

Example 1 – Assessing trade receivables individually

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

Debtor	Amount outstanding (A)	Probability of default (B)	Loss given default (C)	ECL (A x B x C)	Comments
01	$1,000	0.1%	100%	$1	
02	$4,000	0.1%	100%	$4	
03	$15,000	1.0%	20%	$30	Collateral is expected to cover 80% of the debt
04	$1,500	5.0%	100%	$75	Debt is 30 days overdue
05	$5,000	95.0%	100%	$4750	Debt is 90+ days overdue and debtor has ceased trading
06	$10,000	25.0%	0%	$0	Debt is 90+ days overdue but collateral is expected to exceed the debt
07	$2,000	2.0%	100%	$40	Debtor's liquidator advised the expected dividend receivable will be 25% of the debt (i.e.$500). But there's also a 2% chance we won't receive anything at all. N.B. An alternate calculation for Debtor 07 where there are two possible outcomes would be: (A) $2,000 x (B) 100% x (C) 75% = $1,500 *plus* (A) $500 x (B) 2% x (C) 100% = $10 giving the **same total ECL** of $1,510.
		98.0%	75%	$1,470	
08	$3,000	0.1%	100%	$3	
	$41,500			**$6,373**	

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

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

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

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

Example 2 – Identifying debtor groups with similar loss patterns

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

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

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

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

The example percentages are for illustrative purposes only.

	Current	1-30 days	31-60 days	60-90 days	>90 days
Region A debtors (higher losses)	0.6%	4.2%	11.8%	19.6%	39.0%
Region B debtors (higher losses)	0.5%	3.6%	9.6%	14.7%	33.9%
All other regions	0.3%	2.1%	5.9%	9.8%	19.5%

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

Example 3 – Developing a provision matrix

Step 1 – Identify debtor groups with similar loss patterns (see Example 2 above)
An agency has three different revenue streams (A, B and C). Each stream has a different customer base and is processed using a different revenue system. The agency determines that it is appropriate to separately estimate expected loss rates for each revenue stream, due to different customer characteristics and loss patterns.

Step 2 – Obtain historical data
For revenue stream A, the agency has 10 years of available historical data on all debts issued and the subsequent collection or non-collection of those debts. The agency's policy is to write off debts after they are over 90 days overdue, all reasonable recovery efforts have failed, and proper authorisation is obtained for the write off. Details of the 10 years of available historical data is shown in the following table:

All debts issued in the past 10 years	**100,000,000**
Debts collected by due date	91,700,000
Debts collected between 1-30 days past due	6,200,000
Debts collected between 31-60 days past due	1,000,000
Debts collected between 61-90 days past due	600,000
Debts collected after 90 days overdue	350,000
Debts that were eventually uncollected	150,000

Step 3 – Calculate historical loss rates
Using this data, the agency calculates the historical loss rates for each aging band by dividing the uncollectable debts by the total of debts that had cumulatively fallen within each aging category.

Current	All debts issued in the past 10 years	100,000,000	**0.15%**	\$150k / \$100M
1-30 days	Debts that had become overdue	8,300,000	**1.81%**	\$150k / \$8.3M
31-60 days	Debts that had become >30 days overdue	2,100,000	**7.14%**	\$150k / \$2.1M
61-90 days	Debts that had become >60 days overdue	1,100,000	**13.64%**	\$150k / \$1.1M
90+ days	Debts that had become >90 days overdue	500,000	**30.00%**	\$150k / \$500k
	Debts that were eventually uncollected	150,000		

Step 4 – Apply forward-looking adjustments

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

	Historical loss rate	Forward-looking adjustment (5% increase)	**Loss %**
Current	0.15%	0.01%	**0.16%**
1-30 days	1.81%	0.09%	**1.90%**
31-60 days	7.14%	0.36%	**7.50%**
61-90 days	13.64%	0.68%	**14.32%**
90+ days	30.00%	1.50%	**31.50%**

Step 5 – Calculate the loss allowance

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

	Debtor gross carrying amount	Loss %	Lifetime expected credit losses
Current	1,234,000	0.16%	1,944
1-30 days	97,000	1.90%	1,841
31-60 days	31,000	7.50%	2,325
61-90 days	120,000	14.32%	17,182
90+ days	8,000	31.50%	2,520
Loss allowance:			**25,811**

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

Notes:

If an agency does not have the type of data described in Step 2 above, it can instead use historical monthly debtor aging tables to calculate average roll over rates. For example, the agency can calculate the average percentage of current debts that become 1-30 days overdue in the next month, the average percentage of 1-30 days overdue debts that become 31-60 days overdue in the next month, and so on, and multiply the percentages to arrive at loss rates for each aging band.

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

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

FRR 4F Equity, Contributions by Owners and Distributions to Owners

INTRODUCTION

Policy items, indicated by **shaded bold print,** form the Minimum Reporting Requirements (MRRs).

Pursuant to sections 38(2) and 39(2) of the *Financial and Performance Management Standard 2019* (FPMS), departments and statutory bodies must prepare their financial statements in accordance with the MRRs. All of the MRRs are mandatory for departments. Statutory bodies comply with the FPMS by applying the parts of the MRRs that are considered relevant to their circumstances.

Application guidance, indicated by plain text under the "Application Guidance" sub-headings, provides support on interpreting and applying the mandatory policy items and other matters.

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4F.1 STATEMENT OF CHANGES IN EQUITY

REFERENCES

- AASB 101 *Presentation of Financial Statements*

POLICY

- **The required line items for the Statement of Comprehensive Income are as outlined in the corresponding model financial statements unless the line items are not applicable to the entity.**

- **A reconciliation of payments made from Consolidated Fund that are recognised as equity adjustments must be provided as a note to the financial statements. The required line items for the reconciliation are as outlined in the corresponding model financial statements.**

- **Note disclosure is required for the reasons for any material amounts of unforeseen expenditure.**

- **For not-for-profit entities, the asset revaluation surplus must be dissected so as to show separately each class of asset revalued and the closing balance of the asset revaluation surplus by class.**

APPLICATION GUIDANCE

Information on the purpose of the general reserve is required by AASB 101 *Presentation of Financial Statements*. This disclosure should include details of whether it is associated with any cash asset balances within the Statement of Financial Position.

4F.2 RESERVES

REFERENCES

- *Framework for the Preparation and Presentation of Financial Statements*
- AASB 9 *Financial Instruments*
- AASB 101 *Presentation of Financial Statements*
- AASB 116 *Property, Plant and Equipment*
- AASB 121 *The Effects of Changes in Foreign Exchange Rates*
- AASB 138 *Intangible Assets*
-

POLICY

- **An agency must not create a reserve (other than a reserve required by accounting standards e.g. an asset revaluation surplus or a foreign currency translation reserve) without prior Queensland Treasury approval.**

- **A request for Treasury approval must clearly explain the purpose of the reserve and how it will be operated on an ongoing basis, including whether the intended reserve is associated with a future cash outlay.**

- **All such Treasury approved reserves must be reviewed annually for continued appropriateness for the agency's present operations. Where a reserve is no longer appropriate, the balance must be transferred to Accumulated Surplus.**

- **After establishment, subsequent transfers to or from the general reserve will be made by way of an adjustment to Accumulated Surplus. Subsequent increases to a general reserve must be limited to an amount no greater than the positive operating result from continuing operations (net profit) for the financial year.**

- **If a general reserve is no longer appropriate or relevant to operations, the accountable officer of the department or the board of a statutory body must approve the closure of the general reserve. The balance of the general reserve must then be transferred back to the Accumulated Surplus within the same financial year as this approval is given.**

- **Agencies must disclose a reconciliation of each of the movements in the reserve.**

APPLICATION GUIDANCE

Paragraph 65 of the *Framework for the Preparation and Presentation of Financial Statements* (the Framework) states that equity may be sub-classified into reserves that represent either appropriation of Accumulated Surplus or represent capital maintenance adjustments. Such classifications can be relevant to the users of financial statements when they indicate legal or other restrictions on the ability of the entity to distribute or otherwise apply its equity.
The creation of reserves is sometimes required by statute or other law in order to give an added measure of protection from the effect of losses. Transfers to these reserves are appropriations of Accumulated Surplus rather than expenses.

Reserves permitted under Australian Accounting Standards include:

- asset revaluation surplus (AASB 116, AASB 138*)*;
- financial assets at fair value through other comprehensive income (AASB 9);
- foreign exchange translation reserve (AASB 121); and
- cash flow hedge reserve (AASB 9).

The above reserves are used to account for any unrealised gains or losses that would otherwise be recognised in the operating result. The impact of these gains and losses being recorded in the reserves is that the gain or loss is deferred from being recognised in Accumulated Surplus until the point in time that the gain or loss is realised through the completion of a transaction. For example:

- an asset that has had a valuation gain previously recognised in the asset revaluation surplus is sold and the cumulative gain related to that asset is transferred to Accumulated Surplus;
- a transaction for which a cash flow hedge has been recognised is completed and the resultant gain or loss on the hedging instrument is transferred from the reserve to operating result.

General Reserves – no in-principle support by Queensland Treasury

Whilst the creation of general reserves for financial reporting purposes is not specifically prohibited under accounting standards, statute or other law, Queensland Treasury does not in principle support the use of general reserves, other than in exceptional circumstances.

In the past, some public sector entities have used general reserves to demonstrate an internal allocation of cash/funds set aside for future use (e.g. asset replacement plan or for future asset maintenance). Usually, the general reserve is matched with a cash asset balance.

It is Queensland Treasury's position that in a constantly changing fiscal environment, the recognition of general reserves to demonstrate an internal allocation of funds does not provide useful information to users of the financial statements. Agencies are encouraged to consider alternative disclosure or reporting options (i.e. budgets, business plans, additional financial statement notes and/or annual report disclosures) rather than utilising general reserves as a mechanism to inform users of their financial intentions. For example, if:

- the funds are part of a trust account, they are already quarantined and a disclosure note detailing the operation of the trust account would be more informative;

- there is an intention to allocate funds to a specific project or purpose, additional disclosures related to cash, Accumulated Surplus, income and expense or assets and liabilities in either the financial statements or annual report are generally considered more appropriate; or

- the funds are related to a specific function of an agency, then a disclosure on the operations of that function may be more beneficial to users.

Queensland Treasury Considerations for Approving Creation of a General Reserve

There may be rare circumstances in which it will be appropriate for an agency to recognise a general reserve. Queensland Treasury specific approval for an agency to use a general reserve will be based on a particular understanding of how the reserve will be created and maintained, and agencies must provide the following information to Queensland Treasury:

- the purpose of the general reserve and an argument outlining why a general reserve is the most appropriate mechanism to achieve its purpose;
- explanation of how the general reserve will be operated on an ongoing basis;
- demonstration that the general reserve will be reviewed annually for appropriateness to the agency's operations;
- a note as to whether the general reserve is matched with cash/investments that have been set aside for the reserve's purpose; and
- a note as to whether a future cash outlay is associated with the general reserve.

Where an agency has been given Queensland Treasury approval to create a general reserve, the agency will need to have the following documentation and processes in place to manage and report on the reserves:

- documentation to explain the purpose and nature of each general reserve;
- processes to demonstrate that the general reserves will be reviewed annually and adjusted for any expenditure/increases that have occurred during the financial year;
- board minutes, budgets, business plans or other documents verifying the ongoing maintenance of and future commitments relevant to the general reserves; and
- the notes to the financial statements to include:
    - a clear definition of the purpose and nature of each general reserve; and
    - comment disclosing that the general reserve(s) are backed by cash or cash equivalent investments that are set aside for the specific reserve purpose.

Creation, Adjustments and Closure of a General Reserve

AASB 101 requires reclassification adjustments to be recognised in 'Other Comprehensive Income'. However, in accordance with the Framework, except for a capital maintenance adjustment or a revaluation adjustment, a transfer to a general reserve is an appropriation of Accumulated Surplus rather than an expense. Therefore, adjustments to and from a general reserve represent a 'transaction with owners as owners' and must be presented in the Statement of Changes in Equity under the heading 'Transactions with Owners as Owners'.

4F.3 APPLICATION OF INTERPRETATION 1038 TO QUEENSLAND PUBLIC SECTOR ENTITIES

REFERENCES

- *Framework for the Preparation and Presentation of Financial Statements*
- AASB 1004 *Contributions*
- Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities*

POLICY

- **Interpretation 1038 and this policy DO NOT APPLY to transfers between Queensland Government-controlled entities and universities, local governments and statutory bodies established under State legislation but not 'controlled' by the Queensland Government for financial reporting purposes.**

APPLICATION GUIDANCE

Interpretation 1038 applies to transfers of assets and/or liabilities between wholly-owned public sector entities. It establishes criteria for determining whether transfers satisfy the definition of 'contributions by owners' in AASB 1004 and effectively broadens the scope of entities to which the concepts of 'contributions by owners'/"distributions to owners' apply.

Entities considered to be 'wholly owned' by the Queensland Government are those that are 'controlled' by the Queensland Government for financial reporting purposes. For the purposes of Interpretation 1038 and this FRR, statutory bodies 'controlled' by the Queensland Government are considered to be 'owned' by the Queensland Government.

Therefore, non-reciprocal transfers (that meet the criteria set out later in this FRR) between Queensland Government-controlled entities are to be accounted for as contributions by/distributions to owners by the transferor and recipient.

Universities and Local Governments

Whilst universities and local governments are established under State legislation, they are not considered to be 'controlled' by the Queensland Government. As such, any transactions between Queensland public sector entities and universities/local governments are considered to be, and are accounted for, as transactions with a party external to the Queensland public sector.

Immaterial controlled entities of Whole-of-Government

Some public sector entities are "wholly owned" and "controlled" by the Queensland Government, but are not consolidated into the Whole of Government financial statements solely on the grounds of immateriality. For the purposes of applying this FRR policy, such entities are considered in the same way as a party external to the Queensland public sector. As such, this policy does not apply to such entities.

Representatives of the State as 'Owner'

For the purposes of Interpretation 1038 and this FRR, Queensland bodies or individuals capable of representing the State as the 'owner' of Queensland's wholly-owned public sector entities are Cabinet, Cabinet Budget Review Committee (CBRC), Executive Council or portfolio Minister(s) for the agencies concerned (as representatives of the Government as a whole).

4F.4 CRITERIA FOR TRANSFERS TO BE ADJUSTED AGAINST EQUITY

REFERENCES

- *Framework for the Preparation and Presentation of Financial Statements*
- AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*
- AASB 1004 *Contributions*
- Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities*
- *Financial Accountability Act 2009* (FA Act)
- FRR 2F *Machinery-of-Government Changes*

POLICY

- **Transfers of assets and/or liabilities arising from a moG change are contributions by owners and distributions to owners, as the case may be, and are accounted for against equity. The associated Departmental Arrangements Notice is considered adequate to represent the formal approval/designation (as per Interpretation 1038) in respect of the associated transfers of assets/liabilities between departments.**

- **<u>Any other</u> non-reciprocal transfer of assets and/or liabilities (including a net liability position) to another wholly-owned Queensland Government agency is to be treated as a contribution by owners (and a distribution to owners, as appropriate) and accounted for directly against equity ONLY IF the following three criteria are met:**

  - **it is approved by the 'owners' i.e. Cabinet, CBRC, Executive Council or portfolio Minister(s) for the agencies concerned;**

  - **the approval/designation clearly states that the transfer is a capital distribution and/or capital contribution which is adjusted against the transferor's and recipient's equity (constituting the formal designation required under Interpretation 1038). This approval/designation must specify which component(s) of equity (i.e. Contributed Equity, Accumulated Surplus and/or available reserves) are to be adjusted by the agency making the distributions to owners. The approval/designation should specify that the agency receiving the contribution by owners must account for the transfer against Contributed Equity; and**

  - **the approval/designation is obtained at or before the time of the transfer.**

- **Where the State designates that a transfer is to be treated as a total redemption of an ownership interest in the transferor but the balance of the ownership interest is LESS THAN the total net assets transferred, any excess transferred may be designated by the State as a 'contribution by owners'. However, if the approval/designation does not designate the excess as a 'contribution by owners' the balance must be recognised as a gain on redemption of ownership interest in the recipient's operating result.**

- **Where the State designates that a transfer is to be treated as a total redemption of an ownership interest in the transferor but the balance of the ownership interest is GREATER THAN the total net assets transferred, the difference is to be recognised as a loss on redemption of ownership interest in the recipient's operating result.**

- **In all cases (including with moG changes), the transferor and recipient agencies must agree on the values of the assets/liabilities transferred or accept the value as determined by the owner (i.e. Cabinet, Cabinet Budget Review Committee, Executive Council or portfolio Minister(s)) in such a timeframe to ensure the agreed transfer values are reflected in that financial year's annual financial statements.**

Land Under Roads

- **In relation to transfers of untitled land under roads, a once-off approval/designation must be obtained by those agencies that have acquired land designated for road purposes and are for the first time transferring such land to the Department of Resources.**

- **For such transfers to be accounted for against equity, this approval/designation must state that:**

    - **it is enduring in nature;**

    - **all land designated for road purposes is to be transferred to the Department of Resources (or whatever other name the relevant department had at the time of the approval/designation) at least before the end of the reporting period;**

    - **the transfers are a capital adjustment, i.e. to be adjusted against the equity of the transferor and recipient (to the extent that the transferor's Contributed Equity is insufficient, its Accumulated Surplus is to be adjusted); and**

- **In such a timeframe to ensure the agreed transfer values are reflected in that financial year's annual financial statements, the recipient/transferor agencies must agree the value of all land under roads transferred during that year or accept the value as determined by the owner (i.e. Cabinet, Cabinet Budget Review Committee, Executive Council or portfolio Minister(s).**

APPLICATION GUIDANCE

Transfers of assets and/or liabilities are either reciprocal or non-reciprocal. A non-reciprocal transfer is where a recipient and transferor directly assume/transfer assets and/or liabilities without giving/receiving approximately equal value in exchange.

Asset and/or liability transfers as a consequence of machinery-of-Government (moG) changes are examples of non-reciprocal transfers.

Whether a transfer of an asset(s) is voluntary (i.e. at the discretion of an agency) or involuntary (e.g. arising from a machinery-of-Government change), is irrelevant when determining the appropriate accounting treatment. As with all transactions, such transfers should be accounted for according to the substance of the transaction and the requirements of relevant accounting standards and this FRR.

Assets and/or liabilities transferred for no consideration, or for nominal consideration, should generally be transferred at the amounts at which they were recognised by the transferor immediately prior to the transfer. This means, in relation to Property, Plant and Equipment, the gross value, accumulated depreciation and accumulated impairment loss, if any, (as per the records of the transferor at the date of transfer) may be recognised by the recipient, where practicable, as an indication of the age and life cycle of the assets.

Interpretation 1038 does not explicitly consider the treatment for non-reciprocal transfers of liabilities or net liabilities between public sector entities. It is Treasury's view that non-reciprocal transfers of liabilities or net liabilities between Queensland Government entities are distributions to owners, and are to be accounted for in accordance with the principles of AASB 1004 and Interpretation 1038, subject to meeting the criteria of this policy, on the basis of the following:

- there is no AASB pronouncement that specifically applies to this situation;
- pursuant to paragraph 10 of AASB 108, an accounting policy needs to be determined; and

- in determining an appropriate accounting policy, paragraph 11(a) of AASB 108 states that consideration should be given to the applicability of requirements in Australian Accounting Standards dealing with similar and related issues. In this respect, AASB 1004 and Interpretation 1038 contain relevant requirements. Therefore, the principles of those pronouncements form the basis for the policy and guidance in this FRR.

Evidencing the Nature of Equity

Applying the principles in paragraph 8 of Interpretation 1038, a transfer of assets, assets and liabilities, liabilities or net liabilities is a 'contribution by owners'/'distribution to owners' where its equity nature is evidenced by any of the following:

- the issue/cancellation, in relation to the transfer, of equity instruments which can be sold, transferred or redeemed;

- a formal agreement (or amendment thereto), in relation to the transfer, establishing/reducing the financial interest in the net assets of the recipient which can be sold, transferred or redeemed;

- formal designation of the transfer (or a class of such transfers) by the State or a representative of the State as forming part of (or constituting a redemption of) the recipient's Contributed Equity, either before the transfer occurs or at the time of the transfer.

The formal approval/designation may occur in a variety of ways. Whatever means is used, it must specify that the transfer is to be adjusted against the recipient's and transferor's Contributed Equity and/or other components of equity. Refer to the Appendix to this FRR for examples of approvals/designations.

The ability to redistribute Government functions through a moG change evidences the State's capacity to redeem and transfer its financial interest in the net assets of a department. MoG changes are identified by issue of a Departmental Arrangements Notice (DAN).

Under the FA Act the owners' interest in a department can be adjusted directly against equity through appropriated equity injections/withdrawals. Such appropriated equity adjustments are determined by the owners of Queensland's wholly-owned public sector entities. The annual *Appropriation Acts* represent the formal designation required under Interpretation 1038.

To the extent that an equity adjustment is to Contributed Equity, and is not an appropriated equity adjustment under the FA Act, it is known as a non-appropriated equity adjustment.

With any non-reciprocal transfer of assets and/or liabilities, where the State (or a representative thereof) has not issued an approval/designation that meets the criteria in this FRR to enable accounting against equity, the transfer is to be recognised as income or expense, as the case may be.

Specifying components of equity

The State, as owner, has the discretion to distinguish between the entity's Contributed Equity and other components of equity e.g. Accumulated Surplus/Deficit (in accordance with the principles underlying paragraph 31 of Interpretation 1038) when making a distribution. For the purposes of an approval/designation regarding a 'distribution to owners', this means the State can specify the components of equity against which the distribution is to be allocated.

The entity making the transfer of assets and/or liabilities should record a decrease in its assets and/or its liabilities with a corresponding decrease/increase in Contributed Equity or other components of equity in accordance with the approval/designation. Conversely, the receiving entity should recognise a matching increase in assets/liabilities with a corresponding adjustment to its equity.

Generally, contributions by and distributions to owners are adjusted against Contributed Equity. To the extent that a capital contribution or distribution would cause the transferor's Contributed Equity to reduce below $0, the balance should be adjusted against that entity's Accumulated Surplus. In turn, to the extent that this would cause the transferor's Accumulated Surplus to reduce below $0, the balance should be recognised as an expense by the transferor and as corresponding revenue by the recipient.

Reserve balances cannot be transferred between agencies

Reserve balances, including Asset Revaluation Surpluses, cannot be transferred between agencies. Although such balances cannot be transferred, an approval/designation connected with a transfer can specify how a 'distribution to owners' is to be allocated between the various components of equity (including Accumulated Surplus/Deficit and available reserves), consistent with paragraph 31 of Interpretation 1038.

In the context of transfers of assets/net assets, a formal designation can classify part or all of a transfer as a 'redemption of ownership interest' (in the transferor) by the recipient, but only to the extent of the ownership interest recorded by the transferor immediately before the distribution is made (paragraph 43 of Interpretation 1038). This is acceptable because the recipient is receiving a return of its investment (in the form of net future economic benefits). The criteria for accounting for a transfer as a 'redemption of ownership interest' (all or in part) in the transferor are set out in paragraph 13 of Interpretation 1038.

Where a transfer of liabilities/net liabilities meets the criteria for treatment as a 'distribution to owners' for the recipient (and therefore the State can specify the components of equity to be debited in the recipient's books), the transferor must only account for this as an increase in its Contributed Equity (as, under Interpretation 1038, a 'contribution by owners' can only be credited to Contributed Equity). In the context of transfers of liabilities/net liabilities, the owner has the discretion to designate such transfers for the recipient as:

1. a distribution to owners (and a contribution from owners for the transferor)
2. an increase in ownership interest
3. assumption of a liability through profit or loss.

Consistent Classification between Transferor and Recipient

Applying paragraph 11 of Interpretation 1038, if a non-reciprocal transfer of assets/net assets meets this policy's criteria for accounting as a contribution by owners by the recipient, then the transferor entity must classify the transfer as a distribution to owners (unless the transferor makes the transfer to an investee – in which case, the transfer is classified as acquisition of an ownership interest in the recipient).

Similarly, applying the concepts and principles in paragraph 11 of Interpretation 1038, if a non-reciprocal transfer of liabilities/net liabilities meets this policy's criteria for accounting as a distribution to owners by the recipient, then the transferor entity must classify the transfer as a contribution by owners.

Enduring designations

Interpretation 1038 indicates that a designation may be for a class of transfers, such that the designation authorises multiple separate transfers (and associated equity adjustments), and potentially between different entities, over a period of time (in this policy, these are referred to as "enduring designations"). In circumstances where an enduring designation is considered appropriate, the requirements and guidance of this FRR 4F.4 apply as far as relevant. Implementing an enduring designation also demands that the "initiating" agency take ongoing responsibility for reviewing its applicability over time (refer below).

In addition to the requirements and guidance of this FRR 4F.4, enduring designations should:

- adequately describe the nature and purpose (and, where possible, timing) of the transfers so it will be clear whether a specific future transfer is within or outside its scope;

- identify the transferor and transferee entities or, where this is not possible, criteria to identify those entities (similarly, so it will be clear whether a specific future transfer is within or outside its scope). In the case of departments, the designation should be drafted so it allows application to a potential new departmental name after a machinery-of-Government change (if that is the initial intention); and

- incorporate one or more event triggers for the designation to be reviewed, replaced or withdrawn from use. In particular, a significant change to the functions or identity of an entity specifically referred to in the designation would be an appropriate time to revisit the ongoing need for the designation and - where appropriate - to seek approval from the Government 'owners' to replace it with a new designation referring to the current entity name(s).

4F.5 TRANSFERS TO ENTITIES OUTSIDE THE QUEENSLAND PUBLIC SECTOR

POLICY

- **Non-reciprocal transfers of non-cash assets and/or liabilities (including a net liability position) between a department and entities not considered to be controlled by the Queensland Government (refer to section 4F.3) must be recognised through the department's Administered accounts, provided the transfers have been approved, at or before the time of the transfer, by Cabinet, CBRC, Executive Council or portfolio Minister(s) for the agencies concerned, UNLESS a department receives appropriation funding to compensate for any resulting loss. (In the latter situation, the transfer must be accounted for in the department's Controlled Statement of Comprehensive Income.)**

APPLICATION GUIDANCE

If a department meets the above policies to reflect a transfer in its Administered accounts, an initial adjustment should be made against the department's Controlled Contributed Equity account (and/or Accumulated Surplus where the balance of Contributed Equity is insufficient), and then Administered expenses/revenue ultimately need to be recognised.

For example:

Contributed Equity/Accumulated Surplus (controlled)	Dr		130	
Accumulated Depreciation (controlled)	Dr		50	
Accumulated Impairment Losses (controlled)	Dr		20	
Assets (controlled)		Cr		200
(to de-recognise the asset from the controlled accounts)				
Assets (administered)	Dr		130	
Contributed Equity (administered)		Cr		130
(to initially recognise the asset in the administered accounts)				
Grant Expense (administered)	Dr		130	
Assets (administered)		Cr		130
(to recognise the transfer of the asset in the administered accounts)				

Non-reciprocal transfers of assets and liabilities between a statutory body and entities external to the Queensland public sector can only be adjusted through the Statement of Comprehensive Income. This is because each entity belongs to a different economic entity (with different owners), so the transactions between the two entities will not be offset within the whole-of-Government consolidated financial statements. Unlike most departments, statutory bodies do not have administered activities and therefore they cannot adopt the above treatment.

4F.6 DISCLOSURE OF TRANSFERS ADJUSTED AGAINST EQUITY

REFERENCES

- FRR 2A *Basis of Financial Statement Preparation*
- FRR 2F *Machinery-of-Government Changes*

POLICY

- **Where an agency has accounted for asset and/or liability transfers directly against equity during the reporting period, it must disclose, for each asset and liability financial statement line item in its Controlled and Administered statements/notes (as applicable):**
  - **the net transfers in respect of each other agency; and**
  - **the total net transfers to/from other agencies.**
- **The above disclosures are not required in respect of comparative reporting periods.**

APPLICATION GUIDANCE

The disclosure requirements of this FRR 4F.6 are illustrated below. Agencies may use this as a guide for presenting their own disclosures where required but should tailor the wording/structure to reflect their own circumstances.

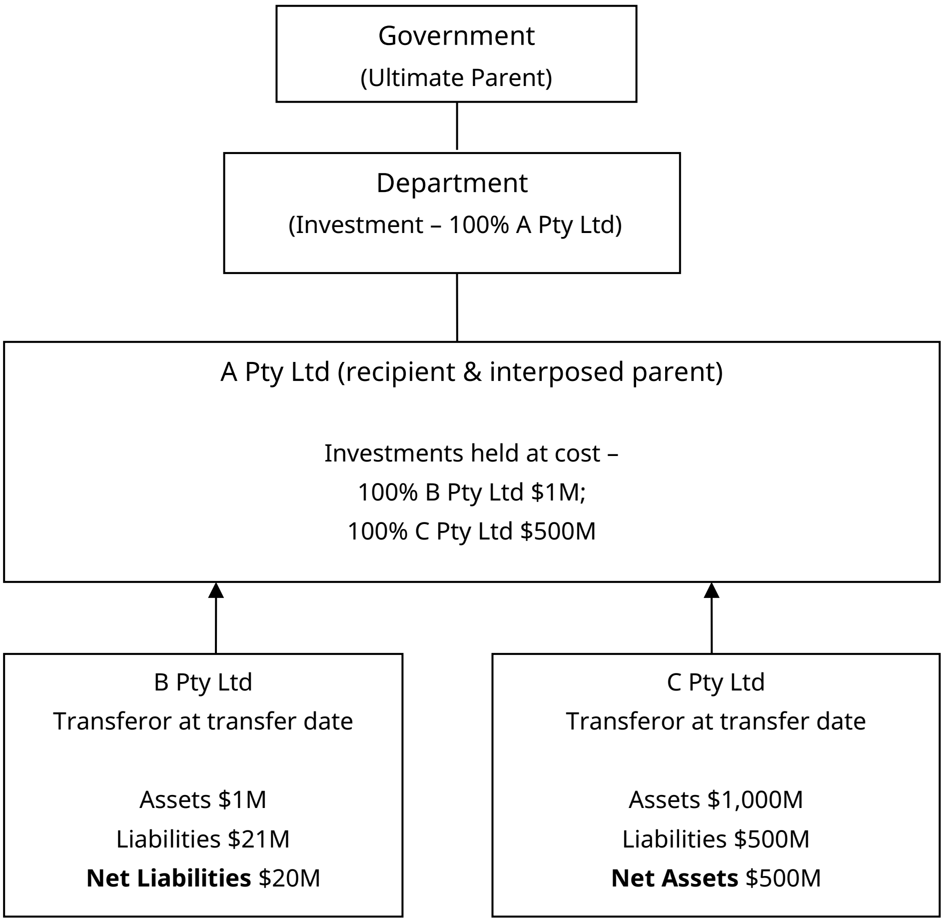
Illustrative Disclosure:

As a result of the Public Service Departmental Arrangements Notice (No. x), dated [Notice commencement date] 20xx, functions relating to wildlife support services were transferred in from the Department of ABC, responsibility for the function relating to the research into the sustainable development and conservation of Queensland's ecology was transferred to the Department of UVW, and the function relating to the development and publication of training material and information packs in relation to the sustainable development and conservation of Queensland's ecology was transferred to the Department of XYZ. As a result of these changes, the following assets and liabilities will be / were [adapt as appropriate] transferred:

Line Item	**Net transfers IN from**	**Net transfers OUT to**	**Net transfers OUT to**	**Net Transfers IN(OUT)**
	Agency ABC $'000	**Agency UVW** $'000	**Agency XYZ** $'000	$'000
<u>Assets</u>				
Cash	*x*	*x*	*x*	*x*
Receivables	*x*	*x*	*x*	*x*
Inventories	*x*	*x*	-	*x*
Non-current assets held for sale	*x*	*x*	-	*x*
Property, plant and equipment	*x*	*x*	*x*	*x*
Intangible assets	*x*	*x*	-	*x*
Investment property	*x*	-	*x*	*x*
Total Assets	*x*	*x*	*x*	*x*
<u>Liabilities</u>				
Payables	*x*	*x*	*x*	*x*
Interest-bearing liabilities and derivatives	*x*	*x*	-	*x*
Accrued employee benefits	*x*	*x*	*x*	*x*
Provisions	*x*	*x*	*x*	*x*
Total Liabilities	*x*	*x*	*x*	*x*
Net Assets(Liabilities)	*x*	*(x)*	*(x)*	*x*

APPENDIX 1 EXAMPLE OF A NET LIABILITY TRANSFER

Example of Contributions by/Distributions to Owners



Background

The Government has made a policy decision to restructure the activities and functions of the group of companies comprising A Pty Ltd, B Pty Ltd and C Pty Ltd, resulting in a wind-up of B Pty Ltd. C Pty Ltd is to transfer one of its borrowings (carrying amount $250M) to A Pty Ltd.

All consequential transfers of assets and liabilities arise from a decision made by Government, without the discretion of any of the entities concerned. To reflect the Government's decisions on the accounting treatment of these transfers, the Government's approvals/designations, finalised before the transfer date, specify the following formal designations:

- The transfer of B Pty Ltd assets and liabilities (i.e. net liabilities) is to be accounted for by A Pty Ltd as a distribution to owners (to be adjusted against A's equity, rather than as an acquisition of an ownership interest), and by B Pty Ltd as a contribution by owners.

- The transfer of one of C Pty Ltd's borrowings is to be accounted for as a distribution to owners (rather than an acquisition of an ownership interest) by A Pty Ltd and a contribution by owners to C Pty Ltd. Both entities are to account for these as an adjustment against Contributed Equity, to the extent that they have a sufficient balance. To the extent that such adjustments would cause the transferor's Contributed Equity to reduce below $0, the balance should be adjusted against that entity's Accumulated Surplus. To the extent that this would cause that entity's Accumulated Surplus to reduce below $0, the balance should be recognised as an expense by the transferor and as corresponding revenue by the recipient.

The following illustrative journal entries assume that each entity has a sufficient credit balance for Contributed Equity.

Accounting Treatment

A Pty Ltd

Assets	Dr	$1M		
Contributed Equity	Dr	$20M		
Liabilities			Cr	$21M

(*Recognition of distribution to owners for the assumption of net liabilities from B Pty Ltd in accordance with formal designation*)

Impairment Loss on Investment	Dr	$1M		
Investment in B Pty Ltd			Cr	$1M

(*Recognition of impairment loss expense re investment asset not realised/recovered following wind up of B Pty Ltd*)

Contributed Equity	Dr	$250M		
Liabilities			Cr	$250M

(*Recognition of assumption of borrowings from C Pty Ltd against Contributed Equity, in accordance with formal designation as a distribution to owners)*

B Pty Ltd

Liabilities	Dr	$21M		
Contributed Equity			Cr	$20M
Assets			Cr	$1M

(*Recognition of transfer of net liabilities to A Pty Ltd on wind up adjusted against Contributed Equity in accordance with formal designation as a contribution by owners*)

Contributed Equity	Dr	$21M		
Accumulated Surplus/Deficit			Cr	$21M

(To clear remaining equity balances following the transfer of net liabilities and the wind up of the company – assumes Contributed Equity balance of $1M prior to transfer)

C Pty Ltd

Liabilities	Dr	$250M		
Contributed Equity			Cr	$250M

(*Recognition of the transfer of a borrowing to A Pty Ltd adjusted against Contributed Equity in accordance with formal designation as a contribution by owners*)

APPENDIX 2 EXAMPLE APPROVAL/DESIGNATION

Example 1. Transfer of an asset between departments

This designation is to effect the transfer of an asset from the transferor [*insert name*] to the recipient [*insert name*].

DESIGNATION OF TRANSFER

Department of [*insert name of transferor department*] transfers [*asset*] to the Department of [*insert name of recipient department*] as a result of a decision made by the owner or a representative of the owner in relation to *[insert event*].

Transfer date – [*insert DD Month YYYY*]

	$'000
Asset transferred to Department of [insert name]	$xxx
Asset transferred from Department of [insert name]	$xxx

or

The value of the asset transferred at date of transfer is to be agreed by [*insert date*].

This designation is made pursuant to AASB Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities* and FRR 4F Equity, Contributions by Owners and Distributions to Owners.

This transfer is designated as contributions by owners for the recipient, which is to be adjusted against the Department of [*insert name of transferor department*] and the Department of [*insert name of recipient department*'s] Contributed Equity, to take effect on [*DD Month YYYY*]. To the extent that this would cause the Contributed Equity of [*the transferor department*] to reduce below $0, the balance is to be adjusted against [*the transferor department's*] Accumulated Surplus. To the extent that this would cause [*the transferor department's*] Accumulated Surplus to reduce below $0, the balance is to be recognised as an expense by [*the transferor*] and corresponding revenue by [*the recipient*].

Approved by:
[Minister's / responsible body's signature]
[Minister's / responsible body's name]
[Minister's / responsible body's position]
[Date]

Example 2. Transfer of Assets to a Parent from its Subsidiary

DESIGNATION OF TRANSFER

This Notice is to effect the transfer of assets from the transferor [insert name of entity] to the recipient) [insert name of entity].

The transfer of assets and other things done under this designation are to be accounted for:

- as a 'distribution to owners' 'by the transferor;
- as a 'redemption of ownership interest' by the recipient; and
- in accordance with AASB Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities*.

The transfer of assets is to be considered as an adjustment of the recipient's ownership interest in the transferor and an adjustment to the transferor's Contributed Equity. To the extent that this would cause the Contributed Equity of [*the transferor entity*] to reduce below $0, the balance is to be adjusted against [*the transferor's*] Accumulated Surplus. To the extent that this would cause [*the transferor's*] Accumulated Surplus to reduce below $0, the balance is to be recognised as an expense by [*the transferor*] and as corresponding revenue by [*the recipient*].

Where the value of the assets transferred is greater than the value of the recipient's investment in the transferor, the balance is to be considered a 'contribution by owners' and therefore an adjustment to the Contributed Equity of the recipient.

This date of this designation is [*dd/mm/yyyy*].

Approved by:

[*Representative of the State as the 'owner'*]
or
[*(If Ministers) Transferor Minister's signature, name, and position*]
or
[*(If Ministers) Recipient Minister's signature, name, and position*]

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