Tech alert

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Significant accounting developments

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Changes to AASB 13, AASB 16 and AASB 101

Key accounting and other developments relevant to 2022–23 financial statements

AASB post-implementation reviews (PIRs): ITC 49, 50 and 51

About this alert

This alert covers:

- an overview of recent amendments to Australian Accounting Standards (AAS) issued by the Australian Accounting Standards Board (AASB), relevant for most Victorian public sector entities, including significant amendments that require your immediate attention
- a reminder of key accounting and other developments relevant to your 2022–23 financial statements
- likely impact of these amendments on Victorian public sector entities
- recommended actions that preparers and auditors can undertake to ensure smooth implementation of these amendments
- an update on the AASB's post-implementation reviews (PIRs).

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Amendments to AAS (effective for future accounting periods)

In a nutshell: amendments and likely impact

The AASB has recently released some significant amendments to accounting standards. Figure 1 summarises the changes, including the likely impact on Victorian public sector entities.

Figure 1: Summary of significant changes to standards (issued but not yet effective)

Amended standard	Effective date	Application type	Likely impact for affected Victorian public sector entities
AASB 13 *Fair Value Measurement*	1 January 2024	Prospective	High
AASB 101 *Presentation of Financial Statements*	1 January 2024	Retrospective	Limited
AASB 16 *Leases*	1 January 2024	Retrospective	Limited

Source: VAGO, based on AASB updates.

In the sections below we cover each change in more detail, including what action preparers and auditors will be required to take.

Amendments to AASB 13

Overview of the amendments

The AASB has amended AASB 13 by including authoritative implementation guidance to be followed by not-for-profit (NFP) public sector entities when fair valuing their non-financial assets not held primarily for their ability to generate cash inflows (non-financial assets).

In the sections below we cover the key amendments, which relate to:

- highest and best use
- developing unobservable inputs
- application of the cost approach.

In its announcement, the AASB has also included examples to illustrate various aspects of the new guidance.

Highest and best use

The amendments to AASB 13 specify that an entity is required to consider whether an asset's highest and best use differs from its current use only when (at the measurement date) either of the following is true:

- the asset is classified as held for sale or held for distribution to owners in accordance with AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*
- it is highly probable that the asset will be used for an alternative purpose to its current use.

Developing unobservable inputs

As a general rule, AASB 13 allows the use of unobservable inputs to measure fair value to the extent that relevant observable inputs are not available.

Unobservable input

An input for which market data is not available and which is developed using the best information available about the assumptions that market participants would use when pricing the asset or liability.

Within the not-for-profit (NFP) public sector, there is generally a lack of availability of observable inputs for most non-financial assets.

Similarly for assets that are unique to the government, observable evidence of assumptions of other market participants, if any, is unlikely to differ from the entity's own assumptions.

Therefore, the implementation guidance clarifies that:

If ...	Then ...
both the market selling price of a comparable asset and some market participant data required to measure the fair value of the asset are not observable	an entity shall use its own assumptions* as a starting point to develop unobservable inputs.

* Those assumptions should be adjusted to the extent that reasonably available information indicates that other market participants would use different data. This means, it is not necessary to undertake exhaustive efforts to obtain market participant assumptions.

Application of the cost approach

The amendments to AASB 13 provide guidance on how the cost approach is to be applied to measure an asset's fair value, including guidance on:

- the nature of costs to include in the replacement cost of a reference asset
- the identification of economic obsolescence.

Likely impact on Victorian public sector entities

The amendments to AASB 13 are the result of considerable effort by the AASB and stakeholders over a number of years. Their aim has been to clarify the requirements of AASB 13 in a public sector context, taking into consideration current practices and the challenges that stakeholders have faced in fair valuing their assets.

In making these clarifications, the AASB has tried to make the requirements less burdensome in some ways. Furthermore, they are expected to help NFP public sector entities apply these requirements consistently.

The impact of these changes on individual entities will depend on the valuation methodologies they are currently following. For some the impact will be minor, but for others it may be high.

Action required by preparers

While the amendments to AASB 13 provide clarity on how to carry out fair valuation of non-financial assets in the public sector, the new requirements still require exercising significant judgement and the application of the standard will continue to evolve. Consequently, a significant amount of debate between valuers, finance managers and auditors is expected on difficult valuations.

To ease this process, there are actions that entities can undertake. Some recommended actions are summarised below:

Recommended action	Purpose and steps
Conduct an impact assessment	It is paramount that entities start getting familiar with the amendments, including: • revisiting current valuation methodologies considering the recent changes • chalking out a detailed action plan to understand the extent of work involved and the impact on financial statements • engaging early with valuers and auditors.

Revisit systems and processes	Entities should review existing systems and processes to ensure they can gather the additional information that may be required for valuing assets as per the amendments. For example: • Release of the 'cost approach' amendments may be a timely prompt for entities to revisit current processes for gathering cost information and ensuring these are working effectively. Where required, these processes can be rationalised. **Tip** To track costs consistently and efficiently, entities can assign simple and consistent descriptors to costs they incur. This will make aggregating these costs easier at the time of subsequent revaluation. This exercise will also help reduce potential gaps between the initial capitalised cost of an asset and the current replacement cost (CRC) that is determined at the time of revaluation. • To aid the valuation process and engagement with auditors, entities should start documenting unobservable inputs/their own assumptions for the purposes of valuing assets. This should be done by preparing position papers, with suitable supporting evidence endorsed by audit committees.
Review disclosure requirements	Entities will need to ensure adequate disclosures are made in financial statements as per the requirements. This includes the following points: • Once entities adopt the amendments, they will need to make disclosures as per AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* regarding 'the nature and amount of the change in asset values'. Undertaking an impact analysis early on will assist with this. • Given the amendments are applicable to future reporting periods, entities should make disclosures as per AASB 108 regarding 'standards issued but not yet effective' in their financial statements for all years until the amendments become effective. • Entities should also look out for the upcoming FRD 120 *Accounting and Reporting Pronouncements Applicable to the 2022-23 Reporting Period.* This lists the standards issued but not yet effective. We expect entities to customise the impact relevant to their situation and avoid boilerplate wording.

Action required by auditors

For impacted entities, the new AASB 13 requirements also mean a significant amount of work in store for their auditors.

Auditors:

- may need to revisit their audit strategy, depending on the nature and complexity of relevant valuations
- should engage with their reporting entities proactively to:
  - assess the impact of the amendments
  - design and implement a course of action, including engagement with management's valuers.
- should also consider whether an auditor's expert will be required.

Conclusion

Given the implementation of the standard is only 2 years away, clients and audit teams need to start talking and significantly brace up for the challenge now.

This will particularly be important for entities falling in the 2024–25 revaluation cycle as per the 'Classification of the functions of government (COFOG)' category. However, entities not in this revaluation cycle will also need to be geared up to conduct fair value assessments and determine whether an interim or managerial revaluation is required, as per the new requirements.

Similar considerations will be required for the local government and university sectors.

Amendments to AASB 101 and AASB 16

Overview of the amendments

The AASB has amended AASB 101 and AASB 16 relating to:

- classifying a liability as current or non-current
- subsequent measurement of lease liabilities arising from sale and leaseback transactions.

AASB 101: Classifying a liability as current or non-current

AASB 2022-6 outlines the requirements for classifying a liability with covenants as current or non-current and enhances disclosure requirements in this regard.

These amendments are in addition to amendments made by AASB 2020-1, which require a liability to be classified as current when an entity does not have a substantive right to defer the settlement of a liability for at least twelve months after the reporting period.

AASB 16: Subsequent measurement of lease liabilities arising from sale and leaseback transactions

AASB 2022-5 has added subsequent measurement requirements for sale and leaseback transactions that satisfy the requirements in AASB 15 *Revenue from Contracts with Customers* to be accounted for as a sale.

AASB 16 already requires a seller-lessee to recognise only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor.

The amendments made by this standard ensure that a seller-lessee subsequently measures lease liabilities arising from a leaseback in a way that does not recognise any amount of the gain or loss related to the right of use it retains.

Likely impact on Victorian public sector entities and action required by preparers

The impact of the amendments to AASB 101 and 16 will depend on each entity's facts and circumstances.

While all entities will need to consider the impact of amending standard AASB 2020–1, which has changed the criteria for determining current-non-current liabilities, the impact of amending standards AASB 2022–6 and AASB 2022–5 will depend on whether an entity has loan agreements with covenants and/or sale and leaseback transactions.

Until the amendments become effective, entities should include disclosures regarding 'standards issued but not yet effective' as per the requirements of AASB 108.

Action required by auditors

Auditors should make enquiries with the reporting entity on the impact of these amendments and determine:

- whether specific liability agreements include covenants and assess the classification of the liability against the criteria in the standard
- whether the entity has sale and leaseback transactions and assess whether the lease liability of the seller-lessee is measured as per the amendments.

Key accounting and other developments relevant to 2022–23 financial statements

Accounting developments

In a nutshell: amendments and likely impact

There are no major accounting developments applicable for the first time in the 2022–23 financial statements. However, there are some key amendments that may be relevant for some entities. These are summarised in Figure 2.

Figure 2: Summary of new accounting pronouncements relevant to 2022–23 financial statements

Amended standard	Effective date	Application type	Likely impact on Victorian public sector entities
Annual Improvements Project 2018–20 AASB 9 *Financial Instruments* AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*	1 January 2022	Prospective	Limited
Illustrative Examples for Not-for-Profit Entities accompanying AASB 15	1 July 2022	N/A	Limited

Source: VAGO, based on AASB pronouncements.

Annual Improvements Project 2018–20

Under this project, key amendments include the following:

- AASB 9: Amendments clarify which fees an entity includes in determining whether a financial liability is substantially modified.
- AASB 137: The amendments specify which costs an entity needs to include when determining whether a contract has become onerous.

AASB 15: Illustrative examples added for NFP entities.

AASB 2022–3 has added Example 7A for NFP entities.

This illustrates how AASB 15 applies to the recognition and measurement of upfront fees charged by the entity to its customers or members.

Likely impact and action required

While the purpose of these amendments is primarily to clarify, they may impact some entities. This will depend on an entity's relevant arrangements and the accounting policy they currently follow.

Each entity will need to consider its circumstances to determine whether these clarifications have any impact on its financial statements, including disclosure requirements as per AASB 108.

The amendments are prospective in nature.

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Other developments

Machinery of government changes

On 5 December 2022, the re-elected government announced a number of machinery of government (MoG) changes.

Departmental CFOs should review these changes and assess the impact on their department, portfolio agencies and administrative offices.

Impacted departments should:

- work together to implement the MoG changes in a timely and effective manner. The 'Victorian public sector operating manual on machinery of government changes' provides a comprehensive source of guidance to assist departments in implementing MoG changes.
- document MoG changes such as the completion of a formal allocation statement between the transferring and receiving department, evidence and timing of such changes etc.
- make additional disclosures in the financial statements and more broadly in the annual report such as details about net asset transfers, direct costs incurred in relation to MoG changes and anticipated future direct costs, if any, etc. These disclosures are required to enable departments communicate the impact of MoG changes on them. To ensure compliance with accounting and reporting requirements, entities should refer to:
  - AASB 1004 *Contributions*
  - AASB Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities*
  - relevant financial reporting directions and Public Accounts and Estimates Committee recommendations
  - DTF's model financial statements, which include illustrative disclosures with respect to such MoG changes.

Post-implementation reviews of Australian Accounting Standards

PIRs announced

The AASB has released 3 invitations to comment (ITCs): 49, 50 and 51. These seek comments from entities on the effectiveness of various standards and on their implementation experiences.

These NFP sector-specific post-implementation reviews (PIRs) are summarised in Figure 3.

Recommended action

We encourage entities to engage with these reviews and get involved in shaping improvements to these standards. This includes sharing specific examples where they considered implementation to be considerably challenging.

Figure 3 summarises the post-implementation reviews, including key dates and links for providing feedback.

Figure 3: PIRs in progress with comment deadlines and information links

ITC reference	Review subject	Comment period end date	Link to further information
ITC 49	Service Concession Arrangements: Grantors	**28 February 2023**	Link
ITC 50	Income of Not-for-Profit Entities	**31 March 2023**	
ITC 51	Not-for-Profit Topics: Control, Structured Entities, Related Party Disclosures and Basis of Preparation of Special Purpose Financial Statements	**31 March 2023**	

Source: VAGO, based on AASB announcements.

Further information

If you wish to discuss any of the information in this Tech Alert, please reach out to your VAGO contact or a member of the Financial Reporting Advisory Team at enquiries@audit.vic.gov.au.