VAGO
Victorian Auditor-General's Office

Financial reporting implications in a changing operating environment

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Overview

Background and context

The Victorian public sector is currently operating in an environment where economic conditions and government priorities continue to evolve, influencing the context in which entities deliver services and prepare their financial reports.

At a broader level, the state continues to implement a range of initiatives aimed at supporting efficiency of government operations. These initiatives, including those arising from the Independent Review of the Victorian Public Service (the Silver Review) form part of the broader policy and operating environment within which public sector entities operate.

These internal settings occur alongside external factors, most notably, geopolitical movements that are contributing to supply disruptions and cost pressures, including elevated fuel and construction costs, which in turn are contributing to sustained inflation. In addition, natural disasters across Victoria during 2025–26 have introduced further financial and operational pressures, adding another layer of complexity to financial reporting, particularly in areas requiring significant judgement and estimation.

As a result, entities are managing continued operating pressures, including increased demand for public services and the rising cost of service delivery.

These factors may affect multiple aspects of the financial statements, including revenue, expenditure, asset valuations, obligations and related disclosures. Their effects may arise through changes in assumptions, estimates and, in some cases, judgement, influencing recognition and measurement of these items.

Accordingly, in this environment, the key financial reporting consideration is how broader operating conditions affect an entity's financial performance and position, and how these effects are reflected consistently across the financial statements. In practice, these impacts are pervasive and need to be considered in a connected way.

About this publication

This publication is intended to support preparers and auditors of public sector entities in consistently assessing the financial reporting implications of the current operating environment.

It highlights key areas in the sections below where emerging economic and policy developments may affect financial reporting and draws on recent developments and examples.

It is not exhaustive and does not replace the need for entity-specific analysis or consultation, particularly where deeper consideration of individual facts and circumstances may be required.

Uncertain economic environment

Implications for asset valuation, impairment and contractual obligations

Accounting standards in play

AASB 116 *Property, Plant and Equipment*, AASB 13 *Fair Value Measurement,* AASB 101 *Presentation of Financial Statements,* AASB 137 *Provisions, Contingent Liabilities and Contingent Assets,* AASB 110 *Events after the Reporting Period,* AASB 136 *Impairment of Assets,* AASB 16 *Leases*

In the Victorian public sector, asset valuations continue to be influenced by a range of macro-economic factors affecting the broader economy. In the 2025–26 financial year, these conditions have been further elevated by geopolitical developments, including increases in fuel and energy prices and flow-on impacts on freight and input costs, as well as movements in interest rates and discount rates. Together, these factors have contributed to sustained increases in material and labour costs, as well as greater uncertainty in cost estimates and delivery timelines.

Key impact area	Financial reporting implications

Asset valuations (current replacement cost) and estimation uncertainty	• Most public sector assets are measured using the current replacement cost approach.
	• From a financial reporting perspective, increases in construction costs and input prices may affect both interim fair value assessments and full asset valuations, particularly for infrastructure and specialised assets measured using a cost approach. These effects highlight the need to incorporate updated replacement cost assumptions when assessing the appropriateness of asset values in the current environment.
	• Entities should ensure that all relevant factors are considered when undertaking fair value assessments, including the current cost environment and the reliability of available data inputs.
	• While we acknowledge the volatility in the external environment, the presence of a significant level of estimation uncertainty should be determined on a case-by-case basis having regard to the availability and robustness of evidence supporting fair value determinations, including assumptions applied, any notes or disclaimers included by valuers in their reports, and the materiality of the resulting valuation outcomes.
	• For example, early discussions with valuers indicate that the impact of the current economic environment may not be fully known for a period of time, and they may include disclaimers or include commentary in their valuation reports highlighting heightened estimation risk. In such cases, entities should ensure these factors are appropriately considered in valuations and reflected in disclosures. At a high level, this may include disclosures about:
	  ◦ key assumptions applied in estimating future outcomes
	  ◦ sources of estimation uncertainty
	  ◦ the classes of assets affected
	  ◦ the carrying amounts of assets subject to significant uncertainty
	  ◦ the sensitivity of carrying amounts to methods, assumptions and estimates, including the reasons for that sensitivity
	  ◦ the expected resolution of the uncertainty and the range of reasonably possible outcomes within the next financial year.
	• Accordingly, disclosures in the financial statements, including those required under AASB 116, AASB 13 and AASB 101 should reflect the specific facts and circumstances of each entity. For example, where available information, assumptions or valuation inputs indicate a range of potential outcomes, or where different sources provide differing indicators of value, preparers should consider whether additional disclosures are necessary to explain the judgements made, key assumptions applied and estimation uncertainty associated with the reported amounts.

Asset valuations (discounted cash flows)	• A key macroeconomic factor affecting asset valuations in the current environment is the movement in interest rates, and the associated impact on discount rates used in valuation models. • An increase in discount rates can affect asset valuations in a number of ways, particularly where entities apply valuation techniques that rely on discounted future cash flows. For example, where a discounted cash flow approach is used, higher discount rates will generally reduce the present value of future cash flows, resulting in lower asset valuations. In these circumstances, it is important for entities to ensure that key assumptions within valuation models – including discount rates, cash flow projections and growth assumptions – appropriately reflect current market conditions and are supported by relevant evidence. • More broadly, increases in interest rates and discount rates may indicate a heightened level of estimation risk in valuation outcomes. While this does not automatically result in material changes to asset values, it reinforces the need for entities to carefully assess whether valuation assumptions remain appropriate and internally consistent.
Impairment assessment including for right of use assets	• In the Victorian public sector, many not-for-profit entities hold non-financial assets primarily for their service potential and measure those assets at fair value on a regular basis. Consistent with AASB 136.Aus5.1, the recoverable amount of these assets is generally expected to approximate their fair value, with the result that impairment requirements are typically less relevant in practice where assets are regularly revalued. • However, impairment considerations remain applicable in certain circumstances, including for public sector entities classified as for-profit and for assets measured using the cost model, such as right-of-use (ROU) assets. In these cases, entities should consider relevant impairment indicators and apply judgement in determining whether an impairment assessment is required, taking into account current economic conditions and other available evidence. For example, a sustained or

Key impact area	Financial reporting implications
	prolonged increase in interest rates may indicate that the carrying amount of ROU assets is no longer recoverable. Accordingly, entities should: • assess whether such changes represent an indicator of impairment • apply judgement in determining the need for impairment testing • ensure any resulting impacts are appropriately reflected in the financial statements

Cost escalation, delays and contractual implications	• Separately, the current environment may give rise to delays, cost escalation and variability in project delivery. Where this occurs, entities should:
	  ◦ monitor contractual arrangements, including pricing mechanisms, escalation clauses and obligations under existing agreements
	  ◦ assess whether increased costs or delays trigger any obligations under AASB 137, including the recognition of provisions or disclosure of contingent liabilities and whether they give rise to any firm commitments as defined in AASB 9
	  ◦ consider whether additional disclosures are required to explain the nature and extent of these impacts.
	• If there is an increased uncertainty in project delivery and pricing, clear and transparent disclosure is important to enable users of financial statements to understand the impact of these conditions on both asset values and contractual positions.

Helen Silver review

Overview

Accounting standards in play

AASB 137 *Provisions, Contingent Liabilities and Contingent Assets,* AASB 119 *Employee Benefits,* AASB 110 *Events after the Reporting Period,* AASB 101 *Presentation of Financial Statements,* AASB 1004 *Contributions,* FRD 119 *Transfers through contributed capital*

The Victorian Government is implementing a range of reform initiatives arising from Helen Silver's review to enhance the efficiency and sustainability of public sector operations. These initiatives include changes to workforce arrangements, reduced reliance on consultants and labour hire, optimisation of office accommodation and progression of shared services. As these reforms are implemented, entities should consider any associated financial reporting implications, including those outlined in the sections below.

Workforce reforms: restructuring and termination benefits

- A number of initiatives arising from the Silver Review, including changes to workforce arrangements and organisational structures may be indicative of restructuring activities under AASB 137.
- However, the announcement of reform initiatives or workforce efficiency measures does not, by itself, give rise to a provision. A restructuring provision is recognised only when the requirements of AASB 137 are met. In practice, this will often depend on whether the entity has established a constructive obligation.
- AASB 137.72 provides that a constructive obligation arises when an entity has both a detailed formal plan and has created a valid expectation among those affected that the restructuring will be implemented.
- While the Silver Review establishes a broad reform agenda across government, the assessment of whether a constructive obligation exists will often need to be undertaken at an individual department or agency level. This will depend on the specific restructuring activities

being implemented, the extent of planning undertaken and the nature of communications made to affected employees and other stakeholders.

- Entities should also consider the accounting requirements for termination benefits as per AASB 119. Termination benefits are recognised at the earlier of when the entity can no longer withdraw the offer of those benefits or when the entity recognises restructuring costs that include the payment of termination benefits. Accordingly, recognition may occur before employees formally separate from the entity.
- Significant judgement may therefore be required in determining the appropriate reporting period in which obligations should be recognised. Key considerations include:
  - the stage of implementation of reform initiatives
  - the extent to which affected employees have been informed of proposed changes
  - whether a valid expectation has been created that the restructuring will proceed.

Classification of liabilities

- Where restructuring or employee-related obligations are recognised, entities should assess whether workforce reform initiatives affect the expected timing of settlement and, consequently, the classification of liabilities as current or non-current.
- Given the Helen Silver review reforms are expected to be implemented progressively over a number of years, classification will depend on the specific facts and circumstances of each initiative. In particular, the existence of a recognised obligation does not necessarily mean settlement will occur within the next 12 months. Entities should consider the nature of the obligation, planned implementation timelines and the timing of communications and commitments made to affected parties when assessing the expected timing of settlement at the reporting date.

Subsequent events

- Developments occurring after the reporting date, but before the financial statements are authorised for issue, may provide additional evidence of conditions existing at balance date or indicate new conditions that require disclosure.
- Entities should consider whether reform announcements or implementation decisions after the reporting period represent adjusting or non-adjusting events.

Entities Legislation Amendment (Consolidation and Other Matters) Act 2026

- Recent legislative reforms, including the *Entities Legislation Amendment (Consolidation and Other Matters) Act 2026*, provide for the abolition, consolidation and restructuring of certain public sector entities as part of broader efficiency measures.
- From a financial reporting perspective, entities should consider the implications of these changes including ensuring that any impacts are appropriately reflected in financial statements and disclosures, having regard to the stage of implementation and the substance of the arrangements.
- Entities should also monitor broader government announcements and policy developments that indicate potential future restructures or consolidations, including where implementation is still in progress or subject to further decisions. In these circumstances, entities may need to assess whether adequate disclosure is required, including in relation to subsequent events or expected structural changes, and whether these developments have implications for the continued appropriateness of the going concern assumption.

Financial reporting risks and judgements

- The current environment may increase financial reporting risks, particularly where organisations are also implementing cost-saving initiatives, workforce changes or other efficiency measures, requiring careful consideration of accounting judgements and estimates.
- Recent amendments to the *Financial Management Act 1994* further reinforce this environment, emphasising the need for entities to operate within approved budgets and enhance the identification and escalation of emerging financial pressures.
- Entities should ensure that sufficient expertise, governance and oversight remain in place to support the preparation of high-quality financial statements, including that:
  - key judgements are appropriate, supportable and consistently applied
  - underlying assumptions and inputs are reasonable and reflect current conditions
  - sufficient and transparent disclosures are provided, particularly in areas involving significant judgement or uncertainty.

Looking ahead

- The reforms arising from the Silver Review are expected to be implemented progressively over a number of years. As reform initiatives evolve, entities should continue to monitor developments and assess their financial reporting implications at each reporting date. For example, in relation to:
  - optimisation of office accommodation costs, entities should consider the impact on leased office space that is no longer required
  - for shared services initiatives involving the consolidation of back-office functions into centralised service providers operating on a fee-for-service basis, entities should monitor cost allocation, expense recognition and related controls.
- Given the phased nature of implementation, accounting outcomes may change as plans become more detailed, commitments are made and affected parties are informed. Accordingly, ongoing assessment will be required to determine whether recognition, measurement, classification or disclosure impacts arise in future reporting periods.

Cost of living pressures and policy decisions by government

Public sector wage negotiations

Accounting standards in play

AASB 119 *Employee Benefits,* AASB 110 *Events after the Reporting Period*, AASB 101 *Presentation of Financial Statements*

Victoria has seen wage disputes in 2025–26, including recent action by teachers and early childhood educators, alongside ongoing negotiations in sectors such as nursing and allied health. These disputes reflect broader pressures across the public sector, particularly around pay competitiveness. From a financial reporting perspective, it is important to understand where each dispute sits within the bargaining cycle – that is, whether negotiations are ongoing, or in principle agreement has been reached, or a formal agreement has been finalised. The status and timing of these outcomes can directly affect recognition and disclosure in financial statements. These are discussed below:

- Consider an example, where an agreement is reached before the reporting date, the financial impact (e.g. revised salary rates and associated on costs) would generally be reflected in the current reporting period. In contrast, where an agreement is reached after the reporting date, entities will need to assess whether this represents an adjusting or non-adjusting subsequent event, depending on whether it provides evidence of conditions existing at balance date.

- In addition, wage outcomes arising from enterprise bargaining may affect key assumptions used in measurement models, particularly those that incorporate salary growth or inflation inputs (e.g. long service leave or other employee benefit provisions). To the extent that wage increases are known or reasonably estimable at balance date, these assumptions should reflect the most current and supportable information available, with appropriate disclosure where estimation uncertainty is significant.
- More broadly, entities should also consider whether ongoing or unresolved bargaining processes give rise to disclosure considerations, including:
  - the extent of uncertainty around future wage outcomes
  - potential variability in forward estimates and cost projections
  - the need to explain significant movements in employee-related expenses.
- Overall, given the scale and timing of wage negotiations across the sector, a clear understanding of bargaining status, timing of agreement, and implications for measurement and disclosure is critical to ensuring financial statements appropriately reflect underlying economic conditions.

Public transport fare policy and implications for broader transport arrangements and government exposures

Accounting standards in play

AASB 15 *Revenue from Contracts with Customers*, AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*, AASB 1059 *Service Concession Arrangements,* AASB 101 *Presentation of Financial Statements*, AASB 110 *Events after the Reporting Period*, AASB 9 *Financial Instruments*

In late March 2026, the Victorian Government announced a policy to provide free public transport across the state until 31 May 2026, followed by half-price fares until 1 January 2027. The policy was introduced in response to cost of living pressures and aims to encourage greater use of public transport, including a potential shift in travel behaviour in the context of fuel availability and price pressures.

While the operational impacts of this decision are visible, some financial reporting implications may be broader and less immediately apparent, particularly where financial outcomes are linked to underlying usage patterns and demand assumptions for toll roads, including certain service concession arrangements, related funding structures or the potential exercise of state guarantees. These are discussed below:

Key impact area	Financial reporting implication
Revenue and expenditure impacts	• The reduction in fares is expected to reduce fare revenue over the policy period. • At the same time, increased patronage and a policy objective to expand service capacity may drive additional operating expenditure, including more frequent services (e.g. additional trains or buses), increased maintenance, cleaning, security and workforce requirements. • Impacted entities should consider whether these effects have been appropriately reflected in financial results and underlying assumptions.
Contractual arrangements, guarantees and funding structures	• Changes in travel behaviour may also result in fewer users relying on private vehicles, which could reduce traffic volumes on toll roads and associated toll revenue. • This may, in turn, affect arrangements where financial outcomes are linked to toll revenue or underlying usage levels, including certain service concession arrangements or related transport funding structures.

Key impact area	Financial reporting implication
	• In some cases, these arrangements may include guarantees or other forms of state support designed to protect against shortfalls in expected toll revenue or usage levels and are typically based on underlying financial models and usage assumptions. • While the impact of the current policy may be short term and may not materially affect these arrangements at present, entities should nevertheless consider whether the assumptions underpinning these arrangements remain appropriate and whether any related obligations or exposures require reassessment. This should be kept under review, particularly if changes in travel patterns persist over time.
Disclosure considerations	• Entities should disclose the financial impact of the policy where material, including any significant judgements applied in assessing contractual arrangements, as well as any relevant subsequent developments identified after the reporting date.

Recoverability of assets and possible government policy responses

- In the current economically uncertain and fiscally constrained environment, including ongoing cost of living pressures, households may face increased difficulty in meeting payment obligations, including rates, fines and other charges. As a result, entities should carefully assess the recoverability of receivables, including whether existing impairment and collectability assessments appropriately reflect current conditions.
- In addition, governments may introduce policy responses such as concessionary arrangements, deferrals or targeted relief measures, which may further affect collectability assumptions. Entities should therefore consider whether these economic conditions and policy responses alter historical collection patterns, and whether this requires updated impairment assessments or enhanced disclosures in the financial statements.

Use of digital technologies and AI

Impact on governance and financial reporting

Accounting standards in play

AASB 138 *Intangible Assets,* AASB 136 *Impairment of Assets,* AASB 101 *Presentation of Financial Statements*

- The current operating environment is also evolving through the increasing use of digital technologies, including AI-enabled systems, across the public sector. As entities adopt these tools they should ensure that underlying data, assumptions and outputs generated through such systems remain reliable and appropriate for financial reporting purposes. This includes considering whether governance, controls and validation processes have been adequately updated to reflect these changes. Appropriate oversight and documentation remain critical, particularly where automated outputs are used to inform significant judgements or disclosures in the financial statements.
- Beyond these considerations, the adoption of AI-enabled technologies may also give rise to specific accounting implications. Entities may need to assess the treatment of expenditure incurred in developing or implementing these solutions, including assessing whether it gives rise to any intangible assets. Entities should also consider the potential for obsolescence of existing platforms or technologies previously recognised as intangible assets, and whether these continue to be recoverable or require impairment. If there are significant judgements involved, these should be disclosed in the financial statements.

Natural disasters

Impact of natural disasters on financial reporting

Accounting standards in play

AASB 1058 *Income of Not-for-Profit Entities*, AASB 116 *Property, Plant and Equipment,* AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*, AASB *101 Presentation of Financial Statements*, AASB 110 *Events after the Reporting Period*

In recent years, Victoria has experienced several significant natural disaster events. This trend continued in the 2025–26 financial year, with the state facing severe storms across 2025, major bushfires in January 2026, and periods of intense rainfall and flooding. These events affected multiple regions, resulting in damage to public infrastructure, disruption to service delivery, and the need for both immediate response and ongoing recovery activities.

Entities, particularly councils, may receive funding to support disaster response and recovery activities, including grants under the Disaster Recovery Funding Arrangements (DRFA), a jointly funded Commonwealth and state program, as well as other state government grants. Various terms and conditions are usually attached to these grants. For example, under the DRFA, entities typically incur eligible expenditure in responding to and recovering from disaster events, and subsequently seek reimbursement of those costs. Funding may be received progressively, including in advance of final claim assessment, and is subject to eligibility criteria, documentation requirements and approval processes. This can give rise to uncertainty regarding the timing and amount of funding ultimately recoverable.

From a financial reporting perspective, entities should consider the following:

Key impact area	Financial reporting implication
Recognition and measurement of funding	The timing of income recognition will depend on when eligibility criteria are met and the extent to which funding is considered recoverable. This requires judgement as funding is contingent on eligible expenditure, claim approval or compliance with specific conditions, including the possibility of partial repayment in some cases.
Nature of funding – capital or operational	Entities should consider whether funding is operational or capital in nature, as this may affect income recognition and the accounting treatment of related assets or projects.
Broader financial impacts	Disaster events may give rise to wider accounting considerations, including impacts on provisions, commitments and contingent liabilities. Entities should also assess the condition of existing assets, including whether damaged assets should be derecognised or whether useful lives and residual values require reassessment.
Disclosure considerations	Entities should disclose the financial impact of disaster-related funding where material, including key judgements applied in assessing eligibility, contractual arrangements and underlying assumptions, as well as any relevant subsequent developments identified after the reporting date.