



Institute of
Public Works
Engineering
Australia

AUSTRALIAN INFRASTRUCTURE FINANCIAL MANAGEMENT GUIDELINES

QUICK GUIDE



Version 1.3 – 2012

This Quick Guide is a supplement to the Australian Infrastructure Financial Management Guidelines.

The Australian Infrastructure Financial Management Guidelines is a initiative of the Institute of Public Works Engineering Australia and its National Asset Management Strategy committee (NAMS.AU) working with the National Local Government Financial Management Forum. The Guidelines were developed with both public sector and private sector industry input from throughout Australia. They are developed to promote best asset and financial management practice for all infrastructure assets regardless of ownership or location.

Important Note to Readers

This is Update 3 to the first version of the Australian Infrastructure Financial Management Guidelines.

For amendments, corrections and updates to this Version, please visit www.ipwea.org.au/AIFMG.

While information contained in these Guidelines is believed to be correct at the time of publication, the Institute of Public Works Engineering Australia and the National Local Government Financial Management Forum and their working parties and agents involved in preparation and publication, do not accept any liability for its contents or for any consequences arising from its use.

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QUICK GUIDE SUPPLEMENT

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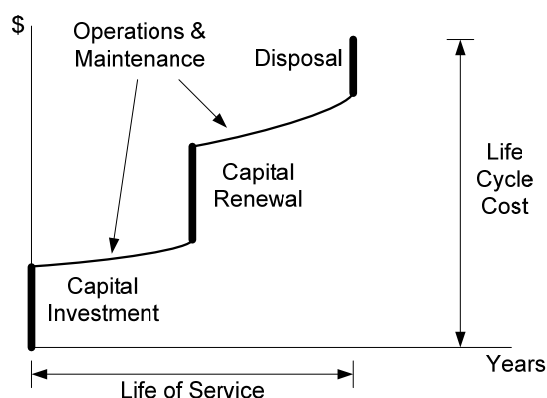
The objective of providing services from infrastructure in a financially sustainable manner requires a joint approach from an asset and financial management point of view.

The task of asset managers is to:

- provide present and future services required or sought by the community,
- at the service level and cost that the community is willing to pay,
- where the cost is based on minimising life cycle cost for any given service level.

The life cycle cost of an asset is shown in Fig 2.

Fig 2: Life Cycle Cost of an Asset



The task of the finance manager is to ensure that the services needed by the community are able to be funded in a financially sustainable, affordable and equitable manner.

The asset manager reports on sustainability in several ways including:

- projected trends in services and service levels, and
- future renewal funding positions.

The finance manager's financial reports disclose the entity's ongoing operating capability.

The financial management perspective is that of maintaining operating capacity, which requires maintaining both infrastructure and financial capital.

The asset manager's objective of achieving sustainable service delivery and the finance manager's objective of maintaining operating capability are one and the same [Section 2.4].

Performance measures are signals used to convey direction being taken by an entity and to assess whether desired outcomes are being met.

Financial indicators provide valuable information to assist managers achieve the position of sustainability. Financial indicators are proposed for eight measures [Section 2.6].

FINANCIAL SUSTAINABILITY INDICATORS

National Indicators

1. **Operating Surplus Ratio**
The operating result expressed as a percentage of total operating income,
2. **Net Financial Liabilities Ratio** – the significance of net amount owed by an entity compared to its operating income for the period,
3. **Asset Sustainability Ratio** – the ratio of asset replacement expenditure relative to depreciation for a period. It measures whether assets being renewed at the rate they are wearing out,
4. **Asset Renewal Funding Ratio** – the ratio of the net present value of asset renewal and replacement funding accommodated over a 10 year period in a long-term financial plan relative to the net present value of projected capital renewal and replacement expenditures identified in an asset management plan for the same period. It assesses the entity's financial capacity to fund asset renewal and replacement in an optimal way.

Secondary Indicators

5. **Operating Surplus** – the excess of operating income (excluding amounts received specifically for new or upgraded assets and donated assets) over operating expenses,
6. **Net Financial Liabilities** – what is owed to others, less money held, invested or owed to the entity,
7. **Interest Cover Ratio** – the proportion of operating income used to pay interest on loans net of interest income,
8. **Asset Consumption Ratio** – the average proportion of 'as new condition' left in assets.



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Updates

Minor updates and corrections to the Guidelines will be available in PDF format for download free of charge from the Guidelines web site www.ipwea.org.au/AIFMG.

Major updates will be published as a new Version of the Guidelines. Information on purchase and availability of major updates will be available from the Guidelines web site www.ipwea.org.au/AIFMG.

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GLOSSARY

Accounting policies

The specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

Accounting standards

A set of rules that govern the way in which financial statements are prepared to ensure that these statements are comparable through time for an entity and across similar entities.

Accrual accounting

Recognition of assets, liabilities, equity, income and expenses (the elements of financial statements) when they satisfy the definitions and recognition criteria for those elements in the Framework for the Preparation and Presentation of Financial Statements. Financial statements prepared on the accrual basis inform users not only of past transactions involving the payment and receipt of cash but also of the obligations to pay cash in the future and of resources that represent cash to be received in the future.

Activity

An activity is the work undertaken on an asset or group of assets to achieve a desired service outcome. The activity is the level at which services are identified in a Program, Sub-Program, Activity based budgeting system.

Advanced asset management (AAM)

Asset management which employs predictive modelling, risk management and optimised decision-making techniques to establish asset lifecycle treatment options and related long term cashflow predictions (See also Core Asset Management)

Amortisation

The systematic allocation of the depreciable amount of an *intangible* asset over its useful life.

Annual Plan

A document produced annually by an organisation to inform stakeholders of its objectives, intended activities, performance, income, and expenditure required for a period of one financial year. It may also indicate anticipated future short-term income and expenditure (See also Management Plan and Operational Plan).

Annual service cost (ASC)

- 1) Reporting actual cost
The annual (accrual) cost of providing a service including operating, maintenance, depreciation, finance/opportunity and disposal costs less revenue.
- 2) For investment analysis and budgeting
An estimate of the cost that would be tendered, per annum, if tenders were called for the supply of a service to a performance specification for a fixed term. The Annual Service Cost includes operating, maintenance, depreciation, finance/opportunity and disposal costs, less revenue.

Asset

A resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity. Infrastructure assets are a sub-class of property, plant and equipment which are non-current assets with a life greater than 12 months and enable services to be provided.

Asset – Property Plant & Equipment

A tangible item that is:

- held for use in the production or supply of goods or services, for rental to others, or for administration purposes, and
- expected to be used during more than one period.

Asset category

Sub-group of assets within a class hierarchy for financial reporting and management purposes.

Asset class

A group of assets having a similar nature or function in the operations of an entity, and which, for purposes of disclosure, is shown as a single item without supplementary disclosure.

Asset condition assessment

The process of continuous or periodic inspection, assessment, measurement and interpretation of the resultant data to indicate the condition of a specific asset so as to determine the need for some preventative or remedial action.

Asset consumption ratio

The average proportion of 'as new condition' left in assets. The ratio shows the depreciated replacement cost of an entity's depreciable assets less their residual value relative to their depreciable amount.

Asset hierarchy

A framework for segmenting an asset base into appropriate classifications. The asset hierarchy can be based on asset function or asset type or a combination of the two.

Asset management (AM)

The combination of management, financial, economic, engineering and other practices applied to physical assets with the objective of providing the required level of service in the most cost-effective manner.

Asset management coordinator

The person appointed by an organisation to ensure the corporate asset management goals, objectives and legal obligations are met. The asset management coordinator may also be required to lead the asset management team.

Asset management information system

An asset management system is a combination of processes, data and software applied to provide the essential outputs for effective asset management such as reduced risk and optimum infrastructure investment.

Asset management plan

A plan developed for the management of one or more infrastructure assets that combines multi-disciplinary management techniques (including technical and financial) over the lifecycle of the asset in the most cost effective manner to provide a specified levels of service. A significant component of the plan is a long-term cashflow projection for the activities.

Asset management strategy

A strategy for asset management covering the development and implementation of plans and programmes for asset creation, operation, maintenance, rehabilitation/replacement, disposal and performance monitoring to ensure that the desired levels of service and other operations objectives are achieved at optimum cost.

Asset management team

The team appointed by an organisation to review and monitor the corporate asset management improvement programme and ensure the development of integrated asset management systems and plans consistent with organisational goals and objectives.

Asset register

A record of asset information considered worthy of separate identification including inventory, historical, condition, construction, technical and financial information about each.

Asset renewal funding ratio (ARFR)

The ratio of the net present value of asset renewal and replacement funding accommodated over a 10 year period in a long term financial plan relative to the net present value of projected asset capital renewal and replacement expenditure identified in an asset management plan for the same period [AIFMG Financial Sustainability Indicator No 4].

Asset sustainability ratio (ASR)

The ratio of asset replacement expenditure relative to depreciation for a period. It measures whether assets are being replaced at the rate they are wearing out [AIFMG Financial Sustainability Indicator No 3].

Australian Accounting Standards Board (AASB)

The AASB is an independent agency of the Australian Government with responsibility to make accounting standards under section 334 of the Corporations Act, to formulate accounting standards for other purposes and to participate in and contribute to the development of a single set of international accounting standards for worldwide use. The Chairman of the AASB reports to the Minister for Superannuation and Corporate Law regarding the organisation's operations.

Australian Equivalents to International Financial Reporting Standards

Accounting Standards and Interpretations issued by the Australian Accounting Standards Board (AASB) that are equivalent to Standards and Interpretations that are issued by the International Accounting Standards Board (IASB).

Average annual asset consumption (AAAC)

The amount of an organisation's asset base consumed during a reporting period (generally a year). This may be calculated by dividing the depreciable amount by the useful life (or total future economic benefits/service potential) and totalled for each and every asset OR by dividing the carrying amount (depreciated replacement cost) by the remaining useful life (or remaining future economic benefits/service potential) and totalled for each and every asset in an asset category or class.

Backlog

The term 'backlog' is not used in these guidelines. See preferred term - Unfunded renewals.

Balance Sheet

A financial statement that presents assets, liabilities and equity of an entity at a given point of time (Alternatively referred to as the Statement of Financial Position).

Bargain purchase option

A clause in the lease agreement allowing the lessee to purchase the asset at the end of the lease for a preset amount, significantly less than the expected residual value at the end of the lease term.

Benefit-cost ratio (B/C)

The sum of the present values of all benefits (including residual value, if any) over a specified period, or the lifecycle, of the asset or facility, divided by the sum of the present value of all costs.

Borrowings

A borrowing or loan is a contractual obligation of the borrowing entity to deliver cash or another financial asset to the lending entity over a specified period of time or at a specified point in time, to cover both the initial capital provided and the cost of the interest incurred for providing this capital. A borrowing or loan provides the means for the borrowing entity to finance outlays (typically physical assets) when it has insufficient funds of its own to do so, and for the lending entity to make a financial return, normally in the form of interest revenue, on the funding provided.

Brookes Law

A method of assessing tenders for contracts where tenders are assessed solely on non-price (quality) attributes, and price negotiations are entered into with the highest attribute scorer.

Brownfield asset values

See under Valuation.

Brownfield valuation

See under Valuation.

Business Plan

A plan produced by an organisation (or business units within it) which translates the objectives contained in an Annual Plan into detailed work plans for a particular, or range of, business activities. Activities may include marketing, development, operations, management, personnel, technology and financial planning.

Capital expenditure

Relatively large (material) expenditure, which has benefits, expected to last for more than 12 months. Capital expenditure includes renewal, expansion and upgrade. Where capital projects involve a combination of renewal, expansion and/or upgrade expenditures, the total project cost needs to be allocated accordingly.

Capital expenditure - expansion

Expenditure that extends the capacity of an existing asset to provide benefits, at the same standard as is currently enjoyed by existing beneficiaries, to a new

group of users. It is discretionary expenditure, which increases future operating, and maintenance costs, because it increases the organisation's asset base, but may be associated with additional revenue from the new user group, eg. extending a drainage or road network, the provision of an oval or park in a new suburb for new residents.

Capital expenditure - new

Expenditure which creates a new asset providing a new service/output that did not exist beforehand. As it increases service potential it may impact revenue and will increase future operating and maintenance expenditure.

Capital expenditure - renewal

Expenditure on an existing asset or on replacing an existing asset, which returns the service capability of the asset up to that which it had originally. It is periodically required expenditure, relatively large (material) in value compared with the value of the components or sub-components of the asset being renewed. As it reinstates existing service potential, it generally has no impact on revenue, but may reduce future operating and maintenance expenditure if completed at the optimum time, eg. resurfacing or resheeting a material part of a road network, replacing a material section of a drainage network with pipes of the same capacity, resurfacing an oval.

Capital expenditure - upgrade

Expenditure, which enhances an existing asset to provide a higher level of service or expenditure that will increase the life of the asset beyond that which it had originally. Upgrade expenditure is discretionary and often does not result in additional revenue unless direct user charges apply. It will increase operating and maintenance expenditure in the future because of the increase in the organisation's asset base, eg. widening the sealed area of an existing road, replacing drainage pipes with pipes of a greater capacity, enlarging a grandstand at a sporting facility.

Capital funding

Funding to pay for capital expenditure.

Capital grants

Revenues received generally from other spheres of government that are tied to specific projects or purposes, which are often for capital upgrade and/or expansion or new investments.

Capital income

See under Income.

Capital investment expenditure

See Capital expenditure definition.

Capitalisation threshold

The value of expenditure on non-current assets above which the expenditure is recognised as capital expenditure and below which the expenditure is charged as an expense in the year of acquisition.

Carrying amount

The amount at which an asset is recognised in the balance sheet after deducting any accumulated depreciation / amortisation and accumulated impairment losses.

Cash

Includes cash on hand, currency, cheques, money orders or electronic transfer that a bank will accept as a deposit and demand deposits.

Cash equivalents

Short-term highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash flow

Cash flows are inflows and outflows of cash and cash equivalents.

Cash flow statement

See Statement of Cash Flows.

Cash-generating unit (CGU)

The smallest identifiable group of assets that generates cash flows that are largely independent of the cash inflows from other assets or groups of assets.

Closed circuit television (CCTV)

The use of video cameras to transmit a signal to a specific place or limited set of television monitors. CCTV methods are used to inspect pipeline assets by sending a mobile video camera along the length of the pipe to visually record the interior.

Complex asset

A physical item of property plant and equipment that is capable of disaggregation into significant components.

Component (of an asset)

Specific parts of an asset having independent physical or functional identity and having specific attributes such as different life expectancy, maintenance regimes, risk or criticality.

Component (of an entity)

Operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.

Condition-based preventive maintenance

Preventive maintenance initiated as a result of knowledge of an item's condition from routine or continuous monitoring.

Condition monitoring

Continuous or periodic inspection, assessment, measurement and interpretation of the resultant data, to indicate the condition of a specific component so as to determine the need for some preventive or remedial action.

Control

The power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Core asset management

Asset management which relies primarily on the use of an asset register, maintenance management systems, job resource management, inventory control, condition assessment, simple risk assessment and defined levels of service, in order to establish alternative treatment options and long-term cashflow predictions. Priorities are usually established on the basis of financial return gained by carrying out the work (rather than detailed risk analysis and optimised decision-making).

Corrective maintenance

The remedial actions performed as a result of failure, to restore an item to a specified condition. Corrective maintenance may or may not be programmed.

Cost of an asset

The amount of cash or cash equivalents paid or the fair value of the consideration given to acquire an asset at the time of its acquisition or construction, including any costs necessary to place the asset into service. This includes one-off design and project management costs.

Costs of disposal

The incremental costs directly attributable to the disposal of an asset or a group of assets, excluding finance costs and income tax expense.

Critical assets

Assets for which the financial, business or service level consequences of failure are sufficiently severe to justify proactive inspection and rehabilitation. Critical assets have a lower threshold for action than non-critical assets.

Current assets

Those assets which the entity either:

- (a) intends to sell or consume in its normal operating cycle; or,
- (b) holds primarily for the purpose of trading; or,
- (c) expects to realise the asset within twelve months after the reporting date; or
- (d) holds and are cash or a cash equivalent (and are not restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period).

Current liability

A liability that the entity either:

- (a) expects to settle in its normal operating cycle; or,
- (b) holds primarily for the purpose of trading; or,
- (c) is due to be settled within twelve months after the end of the reporting date; or
- (d) does not have an unconditional right to defer settlement of for at least twelve months after the reporting date.

Current replacement cost (CRC)

The cost the entity would incur to acquire the asset on the reporting date. The cost is measured by reference to the lowest cost at which the gross future economic benefits could be obtained in the normal course of business or the minimum it would cost, to replace the existing asset with a technologically modern equivalent new asset (not a second hand one) with the same economic benefits (gross service potential) allowing for any differences in the quantity and quality of output and in operating costs.

Data warehouse

A system that is used to centralise a group of disparate databases in an organisation to facilitate access into each of those databases.

Decommission

Activities required to take an asset out of service.

Deferred maintenance

The shortfall in rehabilitation work undertaken relative to that required to maintain the service potential of an asset.

Delphi approach

A group decision-making technique where a number of people are asked their opinions, which are then analysed to produce a best fit result.

Demand management

The active intervention in the market to influence demand for services and assets with forecast consequences, usually to avoid or defer capital expenditure. Demand management is based on the notion that as needs are satisfied, expectations rise

automatically and almost every action taken to satisfy demand will stimulate further demand.

Depreciable amount

The cost of an asset, or other amount substituted for its cost, less its residual value.

Depreciated replacement cost (DRC)

The current replacement cost (CRC) of an asset less, where applicable, accumulated depreciation calculated on the basis of such cost to reflect the already consumed or expired future economic benefits of the asset.

Depreciation / amortisation

The systematic allocation of the depreciable amount of an asset over its useful life.

Depreciation method

The method used to allocate the depreciable amount of an asset over its useful life. This includes, for example the straight-line, diminishing balance or units of production methods.

Deprival value

The value of an asset to the present owner, if the owner were deprived of the asset. Assets are valued at an amount that represents the entire loss that might be expected to be incurred if the entity were deprived of the service potential or future economic benefits of particular assets at the reporting date. If an entity no longer requires, or no longer intends, to provide a service, the nature of the asset changes and the measurement of the asset's deprival value may change. But the concept of deprival value remains applicable to the asset. This is a valuation basis that includes the non-market concept of the value in use of assets as part of a going concern.

Deterioration rate

The rate at which an asset approaches failure.

Discounted cash flow analysis

A method of valuing a project, company, or financial asset or liability based on the concept of the time value of money. All future cash flows and their timing are estimated and discounted to give them a present value. The discount rate used is generally the appropriate cost of capital, and may incorporate judgments of the uncertainty (riskiness) of the future cash flows.

Discounting

A technique for converting cash flows that occur over time to equivalent amounts at a common point in time.

Discount rate

A rate used to relate present and future money values, e.g. to convert the value of all future dollars to the value of dollars at a common point in time, usually the present (see also Effective interest rate).

Disposal

Activities necessary to dispose of decommissioned assets.

Economic life

The period over which an asset is expected to be economically useable by one or more users or the number of production or similar units expected to be obtained from the asset by one or more users.

Economic value

The value of an asset deriving from its ability to generate income which is measured by discounting the net cashflow of the asset by an appropriate risk adjusted discount rate. For non-cash generating assets, the economic value is the value of the goods and services produced or provided to meet the entity's objectives.

Effective interest rate

The rate that exactly discounts estimated future cash payments or receipts through the expected life of the asset to the net carrying amount of that asset or liability.

Entity

Any legal, administrative, or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives.

Equity

The residual interest in the assets of the entity after deducting all of its liabilities.

Expenditure

The spending of money on goods and services. Expenditure includes recurrent and capital outlays.

Expenses

Decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or increases in liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

Facilities audit

The physical audit of a facility, usually required for valuation, life-cycle cost analysis, short-term maintenance planning and long-term planning purposes.

Facility

A complex comprising many assets (e.g. a hospital, water treatment plant, recreation complex, etc.) which represents a single management unit for financial, operational, maintenance or other purposes.

Failure Modes, Effects and Criticality Analysis (FMECA)

A technique for analysing and evaluating a maintenance strategy or life-cycle strategy to ensure that the application has the desired reliability characteristics by obviating those critical failure modes through employment of redundancy, providing alternate modes of operation, de-rating, or any other means.

Fair value

The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties, in an arms length transaction.

Finance lease

A lease that transfers substantially all of the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.

Financial asset

Cash or an equity instrument of another entity or a contractual right or similar that can readily be converted to cash. For example, financial assets include cash deposits, fixed deposits, receivables and investments.³

Financial liability

A contractual obligation to deliver to another entity cash or similar that can readily be converted to cash. For example financial liabilities include bank overdrafts, accounts payable, borrowings and amounts owing under finance leases but exclude liabilities for taxes, operating leases and provisions for outstanding employee entitlements.⁴

Financial plan

A long-term financial plan is a plan for generating, spending and saving future income and raising and repaying borrowings as appropriate. It will cover a period of at least 3 years but preferably longer and will highlight the financial implications of an entity's proposed activities and anticipated events.

³ Refer AASB 132 *Financial Instruments: Presentation* for a more comprehensive definition.

⁴ Refer AASB 132 *Financial Instruments: Presentation* for a more comprehensive definition.

Financial Report (statements)

The financial report consists of a statement of financial position (balance sheet), statement of comprehensive income (income statement), a statement of cash flows, a statement of changes in equity and notes which are an integral part of the financial statements. The objective of financial statements is to provide information about the financial position, performance and cash flows that is useful to a wide range of users for making economic decisions.

Financial Reporting Council (FRC)

Responsible to the Minister for Superannuation and Corporate Law, the FRC provides broad strategic direction and advice to the AASB and AUASB and has oversight of the process for setting accounting standards in Australia. The FRC appoints Board members to the AASB and AUASB various terms.

Financial sustainability for local governments

A local council is sustainable if its infrastructure capital and financial capital is able to be maintained over the long term. Financial sustainability for local governments is being able to manage likely developments and unexpected financial shocks in future periods without having at some time to introduce substantial and economically significant or socially destabilising revenue or expenditure adjustments.

Financing gap

A financing gap exists whenever an entity has insufficient capacity to finance asset renewal and other expenditure necessary to be able to appropriately maintain the range and level of services its existing asset stock was originally designed and intended to deliver. The service capability of the existing asset stock should be determined assuming no additional operating revenue, productivity improvements, or net financial liabilities above levels currently planned or projected. A current financing gap means service levels have already or are currently falling. A projected financing gap if not addressed will result in a future diminution of existing service levels.

Focus group

A method of consulting with representative customers/stakeholders. A focus group typically comprises 6 to 8 people, invited to participate in a discussion about a specified topic, product or service.

Framework

The "Framework for the Preparation and Presentation of Financial Statements" is a pronouncement of the Australian Accounting Standards Board that sets out: the objective of financial statements; assumptions and qualitative

characteristics underlying financial reports; elements of financial reports and recognition criteria for these elements.

Future economic benefit

The future economic benefit embodied in an asset is the potential to contribute directly, or indirectly, to the flow of cash or cash equivalents to the entity. The potential may be a productive one that is part of the operating activities of the entity. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows. For not-for-profit entities, whether in the public or private sector, the future economic benefits are also used to provide goods and services in accordance with the entity's objectives. Future economic benefits are synonymous with the notion of service potential and are used as a reference also to service potential. Future economic benefits can be described as the scarce capacity to provide benefits to the entities that use them and is common to all assets irrespective of their physical or other form.

Future reinstatement cost

The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs whether the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during the period.

Gain on disposal of asset

When the consideration received on the disposal of an asset is greater than the carrying amount of the asset in the accounts of the selling entity.

Gap analysis

A method of assessing the gap between a business's current asset management practices and the future desirable asset management practices. Also called needs analysis.

Generally Accepted Accounting Principles (GAAP)

Approved financial reporting standards so far as those standards apply to a particular entity; or, where there are no approved standards, accounting policies that are appropriate to the entity and have authoritative support within the accounting profession.

General Purpose Financial Report

A financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs.

Geographic Information System (GIS)

Software which provides a means of spatially viewing, searching, manipulating, and analysing an electronic database.

Going concern

An assumption made by accountants in preparing financial statements that the entity is expected to continue in operation for the foreseeable future.

Greenfield valuation

See under Valuation.

Heritage asset

An asset with historic, artistic, scientific, technological, geographical or environmental qualities that is held and maintained principally for its contribution to knowledge and culture and this purpose is central to the objectives of the entity holding it.

Impairment Loss

The amount by which the carrying amount of an asset exceeds its recoverable amount.

Income

Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants (contributed capital). The definition of income encompasses both revenue and gains. Revenue arises in the course of the ordinary activities of an entity and is referred to by a variety of different names including sales, fees, interest, dividends, royalties and rent. Gains represent other items that meet the definition of income and may, or may not, arise in the course of the ordinary activities of the entity. Gains represent increases in economic benefit and include, for example, those arising on the disposal of non-current assets.

- **Capital income** includes gain on disposal of non-financial assets, grants and contributions received specifically for new or upgraded assets and physical resources received free of charge, e.g. from a developer.
- **Operating Income** is income shown in the Statement of Comprehensive Income other than capital income.

Inflation rate

A rate of increase applied to costs incurred at a future date to reflect the comparative purchasing power of money relative to a particular time, usually the present.

Infrastructure assets

Physical assets that contribute to meeting the needs of organisations or the need for access to major economic and social facilities and services, eg. roads, drainage, footpaths and cycleways. These are typically large, interconnected networks or portfolios of composite assets. The components of these assets may be separately maintained, renewed or replaced individually so that the required level and standard of service from the network of assets is continuously sustained. Generally the components and hence the assets have long lives. They are fixed in place and are often have no separate market value.

Intangible Asset

An identifiable non-monetary asset without physical substance.

Interest cover ratio

The proportion of day-to-day income used to pay interest on loans net of interest income. The ratio indicates the extent to which an entity's operating income is committed to meet interest expense.

Interest rate implicit in the lease rate

The discount rate that, at the inception of the lease, causes the aggregate present value of the minimum lease payments and the unguaranteed residual value to be equal to the sum of the fair value of the leased asset and any initial direct costs of the lessor.

Internal rate of return (IRR)

The discount (or interest) rate which will equate the present value of the net cash inflows from a project with its initial cash outlay. The internal rate of return is the true yield and is expressed as the average rate of return per annum or other chosen period.

International Financial Reporting Standards (IFRSs)

Are Standards and Interpretations adopted by the International Accounting Standards Board (IASB) (Refer to Australian equivalents to IFRS).

Inventories

Assets held for sale in the ordinary course of business, in the process of production for such sale, or in the form of materials or supplies to be consumed in the production process or in the rendering of services.

Investment property

Property held to earn rentals or for capital appreciation or both, rather than for:

- use in the production or supply of goods or services or for administrative purposes; or
- sale in the ordinary course of business.

Key performance indicator

A qualitative or quantitative measure of a service or activity used to compare actual performance against a standard or other target. Performance indicators commonly relate to statutory limits, safety, responsiveness, cost, comfort, asset performance, reliability, efficiency, environmental protection and customer satisfaction.

Lease

An agreement whereby the lessor conveys to the lessee in return for a series of payments the right to use an asset for an agreed period of time

Lease term

The non-cancellable period for which the lessee has contracted to lease the asset, together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

Level of service

The defined service quality for a particular service/activity against which service performance may be measured. Service levels usually relate to quality, quantity, reliability, responsiveness, environmental impact, acceptability and cost.

Liability

A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Life

A measure of the anticipated life of an asset or component; such as time, number of cycles, distance intervals, etc.

Life-cycle

The cycle of activities that an asset (or facility) goes through while it retains an identity as a particular asset ie from planning and design to decommissioning or disposal.

Life cycle cost

1. **Total LCC** The total cost of an asset throughout its life including planning, design, construction, acquisition, operation, maintenance, renewal and disposal costs.
2. **Average LCC** The life cycle cost (LCC) is average cost to provide the service over the longest asset life cycle. It comprises average operations, maintenance expenditure plus asset consumption expense, represented by depreciation expense projected over 10 years. The Life Cycle Cost does not indicate the funds

required to provide the service in a particular year.

Life-cycle cost analysis

Any technique which allows assessment of a given solution, or choice from among alternative solutions, on the basis of all relevant economic consequences over the service life of the asset.

Life Cycle Expenditure

The Life Cycle Expenditure (LCE) is the average operations, maintenance and capital renewal expenditure accommodated in the long term financial plan over 10 years. Life Cycle Expenditure may be compared to average Life Cycle Cost to give an initial indicator of affordability of projected service levels when considered with asset age profiles.

Loans / borrowings

See Borrowings.

Lowest price conforming (LPC)

A method of assessing tenders for contracts where the lowest priced tender that passes a minimum set standard for non-price attributes is accepted.

Maintainability

A characteristic of design and installation usually identified by the time and effort that will be required to retain an asset as near as practicable to its new or desired condition within a given period of time.

Maintenance

All actions necessary for retaining an asset as near as practicable to an appropriate service condition, including regular ongoing day-to-day work necessary to keep assets operating, eg road patching but excluding rehabilitation or renewal. It is operating expenditure required to ensure that the asset reaches its expected useful life.

- **Planned maintenance**

Repair work that is identified and managed through a maintenance management system (MMS). MMS activities include inspection, assessing the condition against failure/breakdown criteria/experience, prioritising scheduling, actioning the work and reporting what was done to develop a maintenance history and improve maintenance and service delivery performance.

- **Reactive maintenance**

Unplanned repair work that is carried out in response to service requests and management/supervisory directions.

- **Specific maintenance**

Replacement of higher value components/sub-components of assets that is undertaken on a regular cycle including repainting, replacement

of air conditioning equipment, etc. This work generally falls below the capital/ maintenance threshold and needs to be identified in a specific maintenance budget allocation.

- **Unplanned maintenance**

Corrective work required in the short-term to restore an asset to working condition so it can continue to deliver the required service or to maintain its level of security and integrity.

Maintenance expenditure

Recurrent expenditure, which is periodically or regularly required as part of the anticipated schedule of works required to ensure that the asset achieves its useful life and provides the required level of service. It is expenditure, which was anticipated in determining the asset's useful life.

Maintenance managed item (MMI)

Either an asset or a component of an asset. The MMI level establishes the lowest level of asset that should be recognised and maintained individually.

Maintenance plan

Collated information, policies and procedures for the optimum maintenance of an asset, or group of assets.

Maintenance standards

The standards set for the maintenance service, usually contained in preventive maintenance schedules, operation and maintenance manuals, codes of practice, estimating criteria, statutory regulations and mandatory requirements, in accordance with maintenance quality objectives.

Management plan

See Annual plan.

Market value

The estimated amount at which an asset would be exchanged on the date of valuation, between a willing buyer and a willing seller, in an arm's length transaction and when the parties have each acted knowledgeably, prudently and without compulsion. Market value is based on highest and best use of the asset and not necessarily the existing uses.

Materiality

The notion of materiality guides the margin of error acceptable, the degree of precision required and the extent of the disclosure required when preparing general purpose financial reports. Information is material if its omission, misstatement or non-disclosure has the potential, individually or collectively, to influence the economic decisions of users taken on the basis of the financial report or affect the discharge of accountability by the management or governing body of the entity.

Minimum lease payments

The payments over the lease term that the lessee is or can be required to make, excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with (a) for a lessee, any amounts guaranteed by the lessee or by a party related to the lessee; or (b) for a lessor, a residual value guaranteed to the lessor.

Modern equivalent asset

Assets that replicate what is in existence with the most cost-effective asset performing the same level of service. It is the most cost efficient, currently available asset which will provide the same stream of services as the existing asset is capable of producing. It allows for technology changes and, improvements and efficiencies in production and installation techniques.

Net financial liabilities

A measure of net financial liabilities occurs when the value of financial liabilities exceeds the value of financial assets, a measure which is consistent with the terminology of accounting standards. However, these Guidelines follow the conventional practice used in public sector financial reporting and measure net financial liabilities as the difference between total liabilities less financial assets. Hence, this conventional measure of performance will include the impact of the value of non-financial liabilities such as employee benefits payable and liabilities for taxes payable.

Net financial liabilities ratio (NFLR)

The significance of net amount owed by an entity compared to its operating income for the period. The ratio expresses an entity's net financial liabilities at the end of a period as a percentage of its operating income (excluding amounts received specifically for new/upgraded assets and donated assets) for the period [AIFMG Financial Indicator No. 2.]

Net present value (NPV)

The value to the organisation of the cash flows associated with an asset, liability, activity or event calculated using a discount rate to reflect the time value of money. It is the net amount of discounted total cash inflows after deducting the value of the discounted total cash outflows arising from eg the continued use and subsequent disposal of the asset after deducting the value of the discounted total cash outflows.

Net realisable value

The estimated selling price in the ordinary course of business less estimated costs necessary to make the sale.

New asset

Creation of a new asset to meet additional service level requirements, eg a new building.

Network assets

A network asset is a grouping of assets or components that are individually below the entity's capitalisation policy threshold. Network assets are a practical way of ensuring many small value assets are recognised but as a single asset.

Non-cancellable lease

A lease that is cancellable only upon the occurrence of some remote contingency, or with the permission of the lessor, or if the lessee enters into a new lease for the same or an equivalent asset with the same lessor, or upon payment by the lessee of such an additional amount that, at the inception of the lease, makes the continuation of the lease reasonably certain.

Non-current assets

All assets other than current assets, including assets held but not traded by a business in order to carry out its activities. Such assets are intended for use, not exchange, and normally include physical resources such as land, buildings, drains, parks, water supply and sewerage systems, furniture and fittings.

Non-revenue generating investments

Investments for the provision of goods and services to sustain or improve services that are not expected to generate any savings or revenue to the entity, eg, parks and playgrounds, footpaths, roads and bridges, libraries, etc.

Non-specialised assets

Non-specialised assets include commercial and general purpose buildings and other assets for which there is a secondary market.

Not-for-profit entity

An entity whose principal objective is not the generation of profit. A not-for profit entity can be a single entity or a group of entities comprising the parent and each of the entities that it controls.

Operational plan

See Annual plan.

Operations

Regular activities to provide services such as public health, safety and amenity, eg street sweeping, grass mowing and street lighting.

Operating deficit

An operating deficit occurs when the value of operating income less operating expenses is

negative and operating income is therefore not sufficient to cover all operating expenses.

Operating expenditure

Recurrent expenditure, which is continuously required to provide a service. In common use the term typically includes, eg power, fuel, staff, plant equipment, on-costs and overheads but excludes maintenance and depreciation. Maintenance and depreciation is on the other hand included in operating expenses.

Operating expense

The gross outflow of economic benefits, being cash and non-cash items, during the period arising in the course of ordinary activities of an entity when those outflows result in decreases in equity, other than decreases relating to distributions to equity participants.

Operating expenses

Recurrent expenses continuously required to provide a service, including power, fuel, staff, plant equipment, maintenance, depreciation, on-costs and overheads.

Operating income

See under Income.

Operating lease

A lease other than a finance lease.

Operating surplus

The excess of operating income (excluding amounts received specifically for new/upgraded assets and donated assets) over operating expenses.

Operating surplus ratio (OSR)

The operating result expressed as a percentage of total operating income. [AIFMG Financial Indicator No. 1.]

Operations, maintenance and renewal financing ratio

Ratio of estimated budget to projected expenditure for operations, maintenance and renewal of assets to achieve/maintain specified service levels over a defined time (e.g. 5, 10 and 15 years).

Operations, maintenance and renewal gap

Difference between budgeted expenditures in a long-term financial plan (or estimated future budgets in absence of a long-term financial plan) and projected expenditures for operations, maintenance and renewal of assets to achieve/maintain specified service levels, totalled over a defined time (e.g. 5, 10 and 15 years).

Optimised decision-making (ODM)

Two definitions are:

1. ODM is a formal process to identify and prioritise all potential solutions with consideration of financial viability, social and environmental responsibility and cultural outcomes.
2. An optimisation process for considering and prioritising all options to rectify existing or potential performance failure of assets. The process encompasses NPV analysis and risk assessment.

Optimised depreciated replacement cost (ODRC)

The optimised replacement cost after deducting an allowance for wear or consumption to reflect the remaining economic or service life of an existing asset. ODRC is the surrogate for valuing assets in use where there are no competitive markets for assets, or for their services or outputs.

Optimised deprival value (ODV)

This is a set of rules, rather than a valuation approach, which describe the value boundaries for specified assets employed in monopoly markets. The rules are a combination of a cost based approach (ODRC) and the economic value where the ODV is taken to be the lowest of these.

Optimised replacement cost (ORC)

The minimum cost of replacing an existing asset with modern equivalent assets offering the same level of service. The optimisation process adjusts the value for technical and functional obsolescence, surplus assets or over-design.

Pavement management system (PMS)

A systematic process for measuring and predicting the condition of road pavements and wearing surfaces over time and recommending corrective actions.

PMS score

A measure of condition of a road segment determined from a pavement management system.

Property, plant and equipment

Tangible (physical) assets held by an entity for use in the production or supply of goods or services, for rental to others, or for administrative purposes, and which are expected to be used during more than one accounting period.

Rate of annual asset consumption

The ratio of annual asset consumption relative to the depreciable amount of the assets. It measures the amount of the consumable parts of assets that are consumed in a period (depreciation) expressed as a percentage of the depreciable amount.

Rate of annual asset renewal

The ratio of asset renewal and replacement expenditure relative to depreciable amount for a period. It measures whether assets are being replaced at the rate they are wearing out with capital renewal expenditure expressed as a percentage of depreciable amount (capital renewal expenditure/DA).

Rate of annual asset upgrade/new

A measure of the rate at which assets are being upgraded and expanded per annum with capital upgrade/new expenditure expressed as a percentage of depreciable amount (capital upgrade/expansion expenditure/DA).

Real cost of capital

The cost of capital is equal to the total cost of raising each element of capital (equity plus debt). It can be measured in either before or after tax terms. The real cost of capital is the actual costs adjusted for price increases which may be either the general level of prices (measure of inflation) or specific prices. The real cost of capital may be used as a hurdle rate for investment analysis. For local governments, the real cost of capital is the long term government bond rate adjusted by a local government price increase index.

Recognition

The process of incorporating in the financial statements an item that meets the definition of an asset, liability, income or expense.

Recoverable amount

The higher of an asset's fair value less costs to sell and its value in use.

Recurrent expenditure

Relatively small (immaterial) expenditure or that which has benefits expected to last less than 12 months. Recurrent expenditure includes operating and maintenance expenditure.

Recurrent funding

Funding to pay for recurrent expenditure.

Rehabilitation

See capital expenditure - renewal.

Remaining useful life

The time remaining until an asset ceases to provide the required service level or economic usefulness. Age plus remaining useful life is useful life.

Renewal/refurbishment

Restores, rehabilitates, replaces existing asset to its original capacity, eg gravel resheets. See Capital expenditure - renewal.

Repairs and maintenance

Costs of day-to-day servicing of property, plant and equipment that are primarily labour and consumables, and may include the cost of small parts.

Replacement cost

See Current replacement cost.

Residual value

The estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

Revaluation decrement (increment)

The amount by which the revalued carrying amount of a non-current asset as at revaluation date is less than (exceeds) its previous carrying amount.

Revaluation model

An item of property, plant and equipment is carried at its revalued amount when its fair value can be reliably measured. The revalued amount is the fair value at date of revaluation less any subsequent accumulated depreciation and subsequent impairment losses.

Revenue

The gross inflow of economic benefits e.g. sales, during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants (contributed capital).

Revenue generating investments

Investments for the provision of goods and services to sustain or improve services to the community that are expected to generate some savings or revenue to offset operating costs, eg public halls and theatres, childcare centres, sporting and recreation facilities, tourist information centres, etc.

Risk cost

The assessed annual cost or benefit relating to the consequence of an event. Risk cost equals the costs relating to the event multiplied by the probability of the event occurring.

Risk management

The application of a formal process to the range of possible values relating to key factors associated with a risk in order to determine the resultant ranges of outcomes and their probability of occurrence.

Routine corrective maintenance

Corrective maintenance, excluding emergency corrective and programmed corrective maintenance.

Routine maintenance

Day-to-day operational activities to keep the asset operating (replacement of light bulbs, patching potholes, repairing leaks, etc.) and which form part of the annual operating budget, including preventive maintenance.

Section or segment

A self-contained part or piece of an infrastructure item.

Sensitivity analysis

Testing of the variations in the outcome of an evaluation by altering the values of key factors about which there might be uncertainty.

Service maintenance

Service undertaken seasonally or annually to enable the required level of service to be delivered.

Service potential

The total future service capacity of an asset. It is normally determined by reference to the operating capacity and economic life of an asset. A measure of service potential is used in the not-for-profit sector/public sector to value assets, particularly those not producing a cash flow.

Specialised assets

Specialised assets are assets designed for a specific limited purpose. Specialised assets include buildings such as schools, hospitals, court houses, emergency services buildings (police fire, ambulance and emergency services), specialised buildings to house infrastructure (pump stations, etc.), some heritage properties and most infrastructure assets.

Special Purpose Financial Report

A financial report other than a general purpose financial report. A financial report tailored to meet the specific information needs of a defined user or group of users.

Statement of cash flows

Disclosure of cashflows from all sources relating to the operating, financing, and investing activities of the entity, encompassing all funds maintained by the entity.

Statement of changes in equity

A reconciliation of the equity of an entity at the beginning of a period with the equity at the end of that period. Changes in equity disclosed may include movements in retained earnings for the period, items of income and expense recognised directly in equity, and movements in each class of share and each reserve.

Statement of comprehensive income (alternatively referred to as a statement of financial performance, income statement, operating statement or statement of profit and loss)

A report on the net surplus/deficit, and its components, arising from activities or events during a given period, that are significant for the assessment of both past and future financial performance.

Statement of cost of services

Disclosure of the costs incurred for each significant activity by the reporting entity.

Statement of financial position (alternatively referred to as a balance sheet)

Disclosure of all assets and liabilities of the entity, appropriately classified including resources, financing structure and contingencies.

Statement of objectives

A formal expression of the mission and overall objectives of the reporting entity.

Statement of resources

A description in physical terms of the major resources held by the reporting entity.

Statement of service performance

A report for each significant activity undertaken by the reporting entity, on the degree of success achieved in meeting agreed targets, in qualitative and quantitative terms.

Strategic longer-term plan

A plan covering the term of office of councillors (4 years minimum) reflecting the needs of the community for the foreseeable future. It brings together the detailed requirements in the Council's longer-term plans such as the asset management plan and the long-term financial plan. The plan is prepared in consultation with the community and details where the Council is at that point in time, where it wants to go, how it is going to get there, mechanisms for monitoring the achievement of the outcomes and how the plan will be resourced.

Sub-component

Smaller individual parts that make up a component part.

Substance over form

The financial statements will reflect the underlying economic reality of transactions and other events, and not necessarily their legal form.

Unfunded renewals

The value of asset renewals projected to occur prior to the reporting date. The value of unfunded renewals is reflected in current levels of service.

Unit of Account

The unit in which prices are quoted and accounts are kept for items of non-current physical (infrastructure) assets. The unit of account for infrastructure assets is the component.

Useful life

Either:

- (a) the period over which an asset is expected to be available for use by an entity, or
- (b) the number of production or similar units expected to be obtained from the asset by the entity.

It is estimated or expected time between placing the asset into service and removing it from service, or the estimated period of time over which the future economic benefits embodied in a depreciable asset, are expected to be consumed by the entity.

Upgrade/Improvements

Enhancements to an existing asset to provide higher levels of service, eg widen a sealed road.

Valuation

The process of determining the worth of an asset or liability. Different valuation methods may be appropriate in different circumstances (see also Fair Value).

Valuation (2)

There are two definitions for 'greenfield' and 'brownfield' valuation

- **Brownfield Valuation (A – Accounting)**
Valuation method where the initial recognition and subsequent recognition of assets involves expensing those costs that are considered to be 'sunk' one-off costs for assets that are expected to have an unlimited life such as earthworks and formation for roadworks.
- **Brownfield Valuation (B - Asset Management)**
Valuation Method where the unit valuation rates are based on the cost to replace the asset in its existing developed or built up location.
- **Greenfield Valuation (A - Accounting)**
Valuation method where the initial recognition and subsequent revaluation of assets involves the capitalisation of *all* costs including those for assets that are expected to have an unlimited life such as earthworks and formation for roadwork.
- **Greenfield Valuation (B - Asset management)**
Valuation method where the unit valuation rates are based on the cost to acquire/construct the asset in a 'green field' (undeveloped) location.

Value in Use

The present value of future cash flows expected to be derived from an asset or cash generating unit. It is deemed to be depreciated replacement cost (DRC) for those assets whose future economic benefits are not primarily dependent on the asset's ability to generate net cash inflows, where the entity would, if deprived of the asset, replace its remaining future economic benefits.

Value management

An evaluation process which addresses the technical and functional dimensions at the early stages of a project (i.e. establishment of project objectives, preparation of project brief and consideration of concept/design options) to ensure a fully integrated approach has been taken, the project is consistent with strategic goals, and non-build solutions (including demand management) have been properly assessed.

Weighted attribute method

A method of assessing tenders for contracts where attributes relating to both quality and price are weighted according to the requirements of the business.

Weighted average cost of capital

The weighted average cost of capital (WACC) is the rate that an entity is expected to pay to finance its assets. WACC is calculated by multiplying the cost of each capital component (common equity, preferred equity, straight debt, convertible debt, exchangeable debt, warrants, options, pension liabilities, executive stock options, governmental subsidies, etc) by its proportional weight and then summing.

ABBREVIATIONS

AAAC	Average annual asset consumption	LGA	Local Government Act
AAS	Australian Accounting Standard	LOS	Level of Service
AASB	Australian Accounting Standards Board	LPC	Lowest Price Conforming
AAM	Advanced Asset Management	LUR	Land under Roads
AIFRS	Australian equivalent of International Financial Reporting Standards	MEA	Maintenance Engineering Analysis
AM	Asset Management	MMI	Maintenance Managed Item
AMIS	Asset Management Information System	MMS	Maintenance management system
AMP	Asset Management Plan	NAASRA	National Association of Australian State Road Authorities
AMS	Asset Management Strategy	NAMS.AU	National Asset Management Strategy Australia
AMT	Asset Management Team	NFLR	Net Financial Liabilities Ratio
ARFR	Asset Renewal Funding Ratio	NPV	Net Present Value
ARI	Average recurrence interval	O&M	Operations and maintenance
ASC	Annual Service Cost	ODM	Optimised decision making
ASR	Asset Consumption Ratio	ODRC	Optimised depreciated replacement cost
AUASB	Australian Auditing and Assurance Standards Board	ODV	Optimised deprival value
B/C	Benefit/Cost	OPEX	Operating Expenses
BCR	Benefit cost ratio	ORC	Optimised Replacement Cost
BOD	Biochemical (biological) oxygen demand	OSR	Operating Surplus Ratio
BOO	Build, Own, Operate	PCI	Pavement condition index
BOOT	Build, Own, Operate, Transfer	PFI	Private Finance Initiative
CAD	Computer Aided Design	PMS	Pavement Management System
CAPEX	Capital Expenditure	PPP	Public Private Partnership
CCTV	Closed Circuit Television	PV	Present Value
CGU	Cash Generating Unit	RCM	Reliability Centered Maintenance
CRC	Current replacement cost	ROT	Rehabilitate, operate, transfer
CWMS	Community wastewater management systems	RUL	Remaining useful life
DA	Depreciable amount	RV	Residual value
DCF	Discounted cash flow	SAC	Statement of Accounting Concepts
DRC	Depreciated replacement cost	SCADA	Supervisory Control and Data Acquisition System
EF	Earthworks/formation	SCRIM	Sideways-force Coefficient Routine Investigation Machine
FMECA	Failure Mode, Effects and Criticality Analysis	SLA	Service Level Agreement
FMM	Facilities Maintenance Management	SMART	Specific Measurable Achievable Relevant Timebound
FRC	Financial Reporting Council	SPFS	Special Purpose Financial Statements
GAAP	Generally Accepted Accounting Principles	SS	Suspended solids
GDP	Gross Domestic Product	STEDS	Septic tank effluent drainage scheme
GIS	Geographic Information System	vph	Vehicles per hour
GPFS	General Purpose Financial Statements	WACC	Weighted average cost of capital
HVAC	Heating Ventilation Air Conditioning		
IASB	International Accounting Standards Board		
IFRS	International Financial Reporting Standards		
IIMM	International Infrastructure Management Manual		
IMS	Information management system		
IPWEA	Institution of Public Works Engineering Australia		
IRMP	Infrastructure risk management plan		
IRR	Internal Rate of return		
KPI	Key Performance Indicator		

SECTION 2

SUSTAINABILITY

Key Points

Financial sustainability for entities providing services from infrastructure is being able to manage likely developments and unexpected financial shocks in future periods. These outcomes should be achieved without having at some stage to introduce substantial and economically significant or socially destabilising income or expenditure adjustments.

The asset manager's principal objective is to provide services to communities at agreed service levels and costs at the lowest life cycle cost.

The finance manager has the same objective which in an accounting context is 'maintaining operating capacity'. Entities whose main role is to provide services from infrastructure should adopt the 'physical capital maintenance' concept and the 'entity' viewpoint.

Under the concept of physical capital maintenance, capital is defined in terms of the physical productive capacity of the entity.

The entity viewpoint maintains the physical capacity of the entity to deliver goods and services.

Financial sustainability measures should be selected to give an indication of present performance and future direction.

Core Approach

The organisation monitors its performance and develops its strategic plans using targets and trends. Examples of indicators for monitoring performance are shown in Section 2.6.1.

Advanced Approach

Core approach plus a rigorous long term financial plan supported by an asset management plan for all asset based services covering a period of at least 10 years.

2.1 Financial Sustainability

Financial sustainability is one component of the sustainability issue. It may be applied at the highest level relating to society and in the context of these guidelines, to the role of governments in providing public services.

At the highest level, sustainability can be defined as:

"A means of configuring civilization and human activity so that society and its members are able to meet their needs and express their greatest potential in the present while preserving biodiversity and natural ecosystems, and planning and acting for the ability to maintain these ideals indefinitely."

*Or, in simpler terms, sustainability is providing for the best for people and the environment both now and in the indefinite future."*¹

An example of applying sustainability in the government sector is that of the Western Australia State Sustainability Strategy.

*"meeting the needs of current and future generations through an integration of environmental protection, social advancement and economic prosperity"*²

Financial sustainability focuses on the affordability issues in meeting the needs of the organisation over the long term.

The Local Government Association of Tasmania (LGAT) applied financial sustainability principles for local governments relating sustainability to financial performance and surety for ratepayers.

¹ www.websters-online-dictionary.org/definition/sustainability

² Quoted in LGAT, 2006, p 6.

“The sustainability of a council’s long-term financial performance and position translates to a degree of stability and predictability in the overall rate burden and allows for an equitable distribution of council resources between current and future ratepayers. Sustainable financial performance and position is also essential to the community in terms of the continuation of essential community services and the efficient operation of infrastructure.”³

The NSW Independent Inquiry discussed financial sustainability.

“The NSW Government (NSW Government Fiscal Responsibility Act 2005, section 3(1) defines fiscal sustainability as follows (with “fiscal” sustainability and “financial” sustainability being inter-changeable in a public sector context).

Fiscal sustainability requires that the Government be able to manage financial risks and financial shocks in future periods without having to introduce significant and economically or socially destabilising expenditure or revenue adjustments in those future periods. What is considered consistent with fiscal sustainability will vary depending on the strength and outlook for the economy, the structure of expenditure and revenue of the budget, the outlook for the State’s credit rating, demographic and social trends that will affect the budget, and the nature of financial risks faced by the Government at any given time.

Effectively, a financial sustainability assessment involves a comparison of a Council’s long-term ‘financial capacity’ with its long-term ‘financial requirements’.

A Council’s *financial capacity* means the sum total of the financial resources (both operating and capital) that a Council can mobilise through its (present and prospective) revenue-raising and financing policies.

A Council’s *financial requirements* means the sum total of the spending (both operating and capital) that is necessary by a council to meet both its present statutory obligations and policy choices made about expected additional functions, spending pressures and financial shocks.

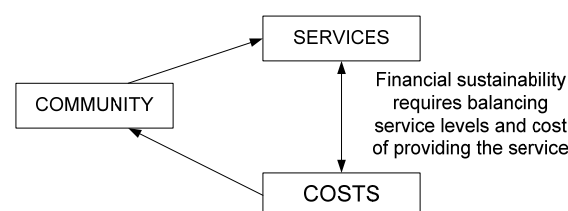
If a council’s long-term finances are sustainable, then disruptive rates increases or spending cuts can be avoided, the rating burden will be fairly shared between current and future ratepayers and the stability or predictability of a Council’s rates will not be at risk.

‘Unsustainable’ finances in the long term only refer to the unsustainability of *current* (revenue-raising and spending) *policies*. Councils finances can almost always be corrected with substantial rating increases and/or expenditure cutbacks.”⁴

Financial Sustainability for Local Government

A local council is sustainable if its infrastructure capital and financial capital is able to be maintained over the long term. Financial sustainability for local governments is being able to manage likely developments and unexpected financial shocks in future periods without having at some time to introduce economically significant or socially destabilising income or expenditure adjustments⁵

Fig 2.1: Services and Financial Sustainability



2.2 A Personal Perspective

The individual is concerned with the standard of living he/she enjoys and the cost that they have to pay to enjoy that living standard. To demonstrate the principles of sustainability, let us look at an example of Joe and Anna deciding whether to buy a car.

Joe and Anna do not have a car. Their mode of transport is by walking or public transport. They find that walking, although good for well-being, has its disadvantages in winter and during rain when they get cold and wet. Public transport services do not serve their needs,

⁴ LGI, Final Report, 2006, Box 11.1, p 284.

⁵ Adapted from Queensland Treasury Corporation quoted in DLGPSR, 2007, p 22.

³ LGAT, 2006, p 7.

Although local government has a large asset stock, it does not have a corresponding large income stream. The ratio of annual operating income to value of aggregate assets under management of the local government sector and similar organisations in the not-for-profit sector that are heavily dependent on infrastructure assets to be able to fulfil their service delivery objectives is approximately one-tenth that of the for-profit (private) sector and one-third that of the State government sector.

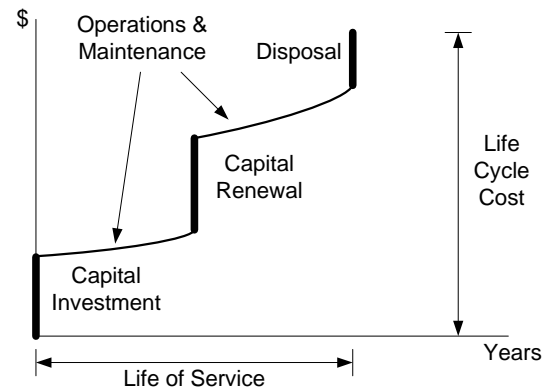
The nature of the services provided by the ‘infrastructure dependent’ not-for-profit sector requires a significantly greater asset base than that typically needed for services by organisations in the for-profit sector. Often there is no direct link between the fees, charges and taxes paid by individuals and the extent of their use of services that infrastructure assets of the not-for-profit sector are used up in providing.

Providing services from infrastructure requires funding of several stages over the life of the service.

1. A capital investment in assets or services required to provide the service.
2. Ongoing operational and maintenance funding to provide the service at the desired service level.
3. Future capital funding to renew the asset when the level of service falls below desired service levels and continuance of the service is required.
4. Funding for demolition or disposal of the asset when the service provided by the asset is no longer required.

The total cost of the asset providing the service over its life is the Life Cycle Cost. Life Cycle Cost for an ongoing asset based service includes the capital investment, operations and maintenance, capital renewal(s) and disposal cost as illustrated by Fig 2.3.

Fig 2.3: Life Cycle Cost of an Asset Based Service



Managing the delivery of services and costs over the life cycle and funding the service provision are joint roles of the asset manager and finance manager.

The services to be provided, how the services are to be provided and the resources required are documented in an asset management plan. Asset management plans should cover a 20 year planning period.

The resources required to provide the services and how these resources are to be provided are documented a long-term financial plan. A long term financial plan should cover a 10 year period.

The life cycle costs of an asset can be several times the initial capital cost as shown in the case study of Life Cycle Costs for sealing a road.

The case study illustrates the asset manager’s perspective of providing services from infrastructure.

It is essential that the operations and maintenance costs and asset renewal costs required to provide the service are funded in order to ensure that the required service levels are available to the community.

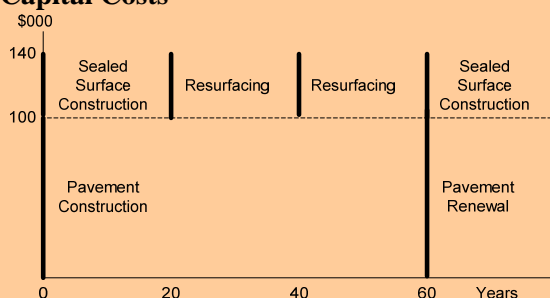
If the required life cycle funding is not available, the result will be a reduction in service levels (or a reduction in service life and higher future costs which equates to the same thing).

Case Study

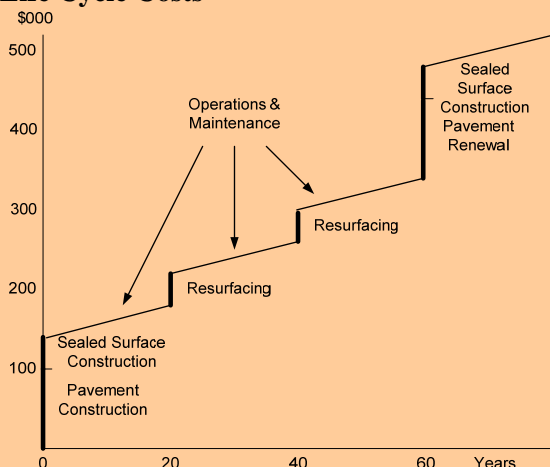
Life Cycle Costs for sealing a road

Estimate	\$	Useful Life
Pavement		
- Capital Cost	100,000	60 years
- Renewal Cost	100,000	
Sealed Surface		
- Capital Cost	40,000	20 years
- Renewal Cost	40,000	
Operations and Maintenance	2,000 / annum	

Capital Costs



Life Cycle Costs



Note: Figures are illustrative only and assume no increase in price.

“Accountants have the responsibility to recognise, record, value and depreciate assets in the financial records and to report thereon.”
 “Subject to an assessment of materiality, accountants must ensure that every asset is recognised at a value that reflects its future service potential to the entity. As the service potential is consumed over time, accountants must ensure that this is reflected by an appropriate depreciation charge being made against revenue in each financial year”.⁶

“In determining the surplus or deficit for a period on the basis of accrual accounting concepts, it is necessary to match the costs of providing the goods and services supplied against revenues. A large part of these costs is the depreciation charge, which represents the service potential of the assets consumed during the period”.⁷

“Current cost profit determination may take place by matching current costs of all kinds against current revenues, this in itself will not ensure proper maintenance of capital. It will assist in this direction, but bad management is capable of wasting capital when prices are rising, or falling or remaining constant”.⁸

Simply accounting for depreciation will not of itself ensure that the funds for asset replacement are retained in the business. If revenue raised is insufficient to offset all operating expenses including depreciation, then accumulated capital or operating capability would then be depleted or dissipated.

Achieving an operating breakeven position or better on average over time is likely to generate sufficient funds to enable renewal or replacement of existing assets and ensure that the physical stock of assets is maintained. Nevertheless because renewal needs are ‘lumpy’ in timing then in some periods there will be surplus funds and in others borrowings (or liquidation of cash and investments – which is equivalent to borrowing) will be necessary to ensure renewal or replacement takes place when optimal to achieve desired service levels while minimising life cycle costs.

2.4 Maintaining Operating Capability

Maintaining operating capability is the accountant’s view of sustainable service delivery.

For not-for-profit entities, maintaining the productive capacity of the entity relates to providing services to its customers/the community. It has been described as “looking after what you already have”.

⁶ BCC, 1993, p 17.

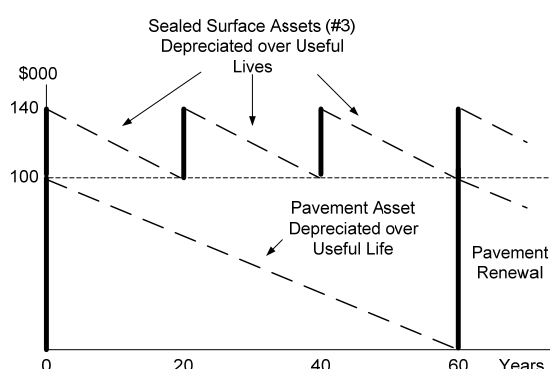
⁷ Gynther, RS, 1996, quoted in BCC, 1993, p 18.

⁸ BCC, 1993, p 22.

Assuming that constructing and sealing of the road creates two new assets, road pavement and road sealed surface, these assets are recognised by the entity and their depreciable amount is depreciated over their useful lives. The road pavement asset is depreciated over its 60 year useful life and the road surface over its estimated 20 year useful life. For the purpose of this example, it is assumed that the future economic benefits embodied in the assets are consumed at a constant rate.

The recognition and depreciation of the asset is illustrated in Fig 2.5.1. Note this example assumes a steady state condition with no revaluations nor price increases and reconstruction of the pavement at end of life (no residual value).

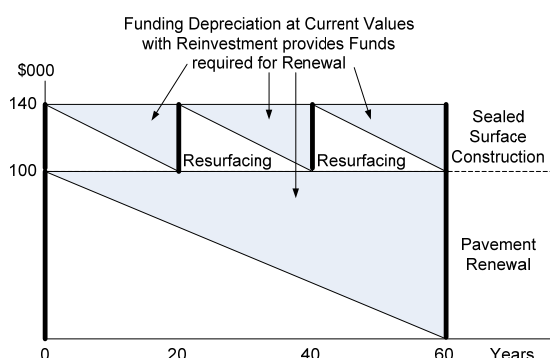
Fig 2.5.1: Recognition and Depreciation of New Road Assets



Funding depreciation generates funds required for reinvestment in assets and sustaining the service.

Using current asset values and investing funds generated by funding depreciation provides the funds required to renew the asset at end of its useful life, as shown in Fig 2.5.2

Fig 2.5.2: Funding Renewal of Road Assets



From the asset management perspective, this process provides the mechanism to ensure that the funding required to provide services at the agreed service level is available when required and meets the asset management objective of sustainable service delivery.

The financial management perspective is that of maintaining operating capability. The consumption of economic benefits (or service potential) is recognised as a charge paid by present consumers of the asset, generating funds that may be used to renew the asset to maintain operating capability in future.

This is a very simplistic representation of the principles of sustainable service delivery and maintaining operating capability for the two sealed road assets created by this investment.

In reality, infrastructure entities have tens of thousands of assets at varying stages of progress through their life cycle and the asset management, valuation, asset accounting and financial management issues and process are far more complex than this example.

The asset manager's objective of achieving sustainable service delivery and the finance manager's objective of maintaining operating capability are one and the same.

2.6 Performance Measures

The Australian Local Government and Planning Ministers Council's Local Government National Financial Sustainability Frameworks describe indicators (performance measures) as "signals used to convey directions being taken by a council and to assess whether or not desired outcomes are being achieved.

To be effective, it is essential that indicators:

- measure those factors which define financial sustainability,
- be relatively few in number, and
- be based on information that is readily available and reliable".¹²

Performance measures can only tell part of the story. They only measure outputs or outcomes, individually and without any associated explanations. Performance

¹² LGPMC, 2007, Framework 1, p 4.

measures only give an indication of where to look to reasons behind any differences or trends. They assist in analysing what is behind the performance measure.

Performance measures can be in two areas.

1. to indicate present position and past trends,
2. to indicate future direction and need for action and change.

2.6.1 Financial Indicators

South Australia was the first State in Australia to require councils to develop a long-term financial plan and an asset management plan as part of their suite of strategic management plans, including to address:

- the sustainability of their financial performance and position,
- the maintenance, replacement or development needs for infrastructure within their area, and
- proposals with respect to debt levels.”¹³

SA Councils also are required to “state the measures (financial and non-financial) that are to be used to monitor and assess the performance of the council against its objectives over the relevant period”.¹⁴

While a set of eight financial indicators based on those developed in SA is shown in Table 2.6.1.2, all jurisdictions in Australia agreed in principle, in October 2011 to adopt four key nationally consistent indicators¹⁵. Jurisdictions agreed that reporting on a smaller rather than larger number of indicators helps decision makers and stakeholders focus on and comprehend key outcomes and implications. The four national indicators are shown below, along with secondary indicators.

Indicative targets or target ranges are shown in the table based on current guidance provided in States. Entities should determine locally appropriate target ranges based on future community needs while ensuring that the entity’s long-term financial sustainability can be maintained or achieved.

¹³ LGA, 2006, p 2.

¹⁴ Local Government Act 1999, Sec 122 (1) (d) quoted in LGA, 2006, p 2.

¹⁵ ACELG, 2011.

NATIONAL INDICATORS

1. Operating Surplus Ratio

The operating result expressed as a percentage of total operating income.

2. Net Financial Liabilities Ratio

The significance of net amount owed by an entity compared to its operating income for the period.

3. Asset Sustainability Ratio

The ratio of asset replacement expenditure relative to depreciation for a period. It measures whether assets are being renewed at the rate they are wearing out.

4. Asset Renewal Funding Ratio

The ratio of the net present value of asset renewal and replacement funding accommodated over a 10 year period in a long-term financial plan relative to the net present value of projected asset capital renewal and replacement expenditure identified in an asset management plan for the same period. It assesses the entity’s financial capacity to fund asset renewal and replacement in an optimal way.

SECONDARY INDICATORS

5. Operating Surplus

The excess of operating income (excluding amounts received specifically for new or upgraded assets and donated assets) over operating expenses.

6. Net Financial Liabilities

What is owed to others less money held, invested or owed to the entity.

7. Interest Cover Ratio

The proportion of operating income used to pay interest on loans net of interest income.

8. Asset Consumption Ratio

The average proportion of ‘as new condition’ left in assets.

Results for the eight financial indicators are shown in Table 2.6.1.2 using a simplified Statement of Comprehensive Income and Statement of Financial Position from a hypothetical Council shown in Tables 2.6.1 and 2.6.1.1.

Table 2.6.1: Hypothetical Council Statement of Comprehensive Income

	Current Year (\$000)	Previous Year (\$000)
INCOME		
Rates	39,800	37,500
Statutory Charges	1,200	1,100
User Charges	1,500	1,400
Grants, Subsidies & Contributions ^	4,800	4,800
Investment Income	200	200
Reimbursements	500	400
Commercial Activity Income	200	200
Other Operating Income	300	500
Net gain (Loss) – joint ventures & associates	(200)	100
Total Operating Income	48,300	46,200
EXPENSES		
Employee Costs	18,900	18,200
Contractual Services	10,600	10,900
Materials	3,700	3,700
Finance Costs	500	500
Depreciation	8,800	8,700
Other Expenses	4,700	4,500
Total Operating Expenses	47,200	46,500
OPERATING SURPLUS / (DEFICIT)	1,100	(300)
Amounts received specifically for new or upgraded assets	1,000	700
Physical resources received free of charge	500	700
Other comprehensive income		
Net Gain (Loss) on revaluation of assets *	0	500
Net Gain (Loss) on disposal of assets	500	300
NET SURPLUS / DEFICIT	3,100	1,900

Note: ^ Grants Subsidies and Contributions. All grants, subsidies, contributions, etc that do not meet the criteria for disclosure as *amounts specifically for new or upgraded assets* or *physical resources received free of charge* are to be included in *grants, subsidies and contributions*. Details for determining *amounts received specifically for new or upgraded assets* and *physical resources received free of charge* are shown in Section 2.6.2.

Note: * A gain on revaluation will only be included where it reverses a previous decrement in the asset or same class of asset.

Table 2.6.1.1: Hypothetical Council Statement of Financial Position

	Current Year (\$000)	Previous Year (\$000)
Assets		
Cash & Cash Equivalents	2,200	2,700
Trade & Other Receivables	1,000	1,000
Inventories	4,800	4,800
Land	134,500	133,700
Buildings	34,200	34,700
Infrastructure	254,400	250,300
Plant & Equipment, Furniture & Fittings	7,300	6,700
Equity in Council Businesses	800	800
Other Financial Assets	900	1,000
Other Assets (Inc. Library Books & Work in Progress)	2,000	1,900
Total Assets	442,100	437,600
Liabilities		
Trade & Other Payables	4,800	4,900
Employee Entitlements	3,200	3,100
Borrowings, Overdraft, Finance Leases, Deposits held	7,700	8,700
Other Liabilities	0	100
Total Liabilities	15,700	16,800
Equity		
Asset Revaluation Reserve	124,500	123,400
Accumulated Surplus / (Deficit) & Other Reserves	301,900	297,400
Total Equity	426,400	420,800

Table 2.6.1.2: Calculation of Financial Indicators for Hypothetical Council

NATIONAL INDICATORS

Indicator	Description	Comment	Calculation (\$M)	Indicative Target
1. Operating Surplus Ratio	The operating result expressed as a percentage of total operating income.	The operating surplus ratio is the operating surplus (deficit) expressed as a percentage of total operating income.	Operating surplus (deficit) divided by total operating income. Operating surplus = \$1.1 M Total operating income = \$48.3 M Operating Surplus Ratio = 2% [1.1 / 48.3 = 2%]	An operating surplus ratio between 0% and 10% over any five year period. ¹⁶
What does it Mean?		The ratio provides a measure of the extent to which operating income is sufficient or insufficient to meet the cost of services (i.e. expenses). Proposed nationally consistent measure of a Council's financial performance .		

¹⁶ Note, NSW LGI suggested a target of 5% (range 0% - 10%) and Access Economic (Tas Report) 2½% - 7½% of own source income (not total income).

Indicator	Description	Comment	Calculation (\$M)	Indicative Target
2. Net Financial Liabilities Ratio	The significance of net amount owed by an entity compared to its operating income for the period.	The ratio expresses an entity's net financial liabilities at the end of a period as a percentage of its operating income (excluding amounts received specifically for new/upgraded assets and donated assets) for the period.	<p>Net financial liabilities (total liabilities less financial assets) divided by operating income</p> <p>Net Financial Liabilities = \$11.6 M Total operating income = \$48.3 M</p> <p>Net Financial Liabilities Ratio= 24% [11.6 / 48.3 = 24%]</p>	Net financial liabilities between zero and 100% of operating income. ¹⁷
	What does it Mean?	<p>Where the ratio is falling over time, it indicates the entity's capacity to meet its financial obligations from operating income is strengthening.</p> <p>Reasons for an increase in the net financial liabilities ratio will sometimes also result in an entity incurring higher net operating costs (eg from additional maintenance and depreciation costs associated with acquiring new assets). This will detract from the entity's overall operating result.</p> <p>A Council with a healthy operating surplus could quite appropriately decide to allow its net financial liabilities ratio to increase in order to provide additional services to its community through the acquisition of additional assets without detracting from its financial sustainability.</p> <p>An ongoing negative net financial liabilities ratio implies that an entity places higher priority on accumulating financial assets than applying funds generated from ratepayers to the provision of services.</p> <p>Proposed nationally consistent measure of a Council's financial position.</p>		

¹⁷ Note; NSW LGI suggested a target of 100% (range 50% - 150%).

Indicator	Description	Comment	Calculation (\$M)	Indicative Target
3. Asset Sustainability Ratio	The ratio of asset replacement expenditure relative to depreciation for a period. It measures whether assets are being replaced at the rate they are wearing out.	Indicates whether the entity is replacing or renewing its non-financial assets in an optimal way so as to minimise whole-of-life costs of an assets (and thus cost-effectively maintain preferred service levels).	Capital expenditure on replacement/renewal of existing plant and equipment and infrastructure assets divided by their annual depreciation expense. Capital renewal expenditure = \$7.9 M * Depreciation expense = \$8.8 M Asset Sustainability Ratio = 90% [7.9 / 8.8 = 90%]	Target to be set having regard for the relative age and replacement/renewal profile of the entity's asset portfolio.
What does it Mean?		If ratio is 100% on average over time, entity is ensuring value of existing physical assets is maintained. Entities should be replacing/renewing assets when they need to be replaced. When assets portfolios are young, this can be 50% or less. When the assets are old, the ratio may be more than 100%.		

Note: * Not disclosed in financial statements prepared in conformity with Australian Accounting Standards. Some jurisdictions require disclosure as a note to the financial statements. Amount above has been assumed for illustrative purposes.

Indicator	Description	Comment	Calculation (\$M)	Indicative Target						
4. Asset Renewal Funding Ratio	The ratio of the net present value of asset renewal and replacement funding accommodated over a 10 year period in a long-term financial plan relative to the net present value of projected asset capital renewal and replacement expenditure identified in an asset management plan for the same period.	Indicates whether the entity has the financial capacity to fund asset renewal and replacement in an optimal way and therefore continue to provide existing levels of asset based services in future without additional operating income or reductions in operating expenses or increase in net financial liabilities above that currently projected.	<p>The net present value of projected 10 year capital renewal and replacement funding outlays in a long-term financial plan divided by the net present value of projected 10 year capital renewal and replacement expenditures in an asset management plan in current values.</p> <p>NPV of LTFP projected outlays = \$59.6 M</p> <p>NPV of AMP projected expenditures = \$86.9 M</p> <p>Asset Renewal Funding Ratio = 69% [59.6 / 86.9]</p> <p>Calculation of real discount rate for NPV*</p> <table><tr><td>Nominal discount rate</td><td>8%</td></tr><tr><td>Inflation expectation estimate</td><td>3.5%</td></tr><tr><td>Real discount rate</td><td>4.35%</td></tr></table> <p>[1.08 / 1.035]</p>	Nominal discount rate	8%	Inflation expectation estimate	3.5%	Real discount rate	4.35%	Asset renewal funding ratio lies between 90% and 100%.
Nominal discount rate	8%									
Inflation expectation estimate	3.5%									
Real discount rate	4.35%									
What does it Mean?		This indicator is a measure of the ability of the entity to fund its projected asset renewals/replacements in the future.								

Note: * Asset management plan expenditure projections are generally expressed in current values. Where expenditure and funding projections are in current values, a *real* (net of inflation) discount rate is used for Net Present Value calculations. For projections in inflated values, a *nominal* discount rate (inclusive of inflation) is used.

The *nominal* discount rate is the estimate of future inflation in this case over 10 years. For example; a measure commonly used as the *nominal* discount rate is the market yield on 10 year government bonds.

SECONDARY INDICATORS

Indicator	Description	Comment	Calculation (\$M)	Indicative Target
5. Operating Surplus	The excess of operating income (excluding amounts received specifically for new and upgraded assets and donated assets) over operating expenses.	An operating surplus (deficit) arises when operating income (excluding capital income) exceeds (is less than) operating expenses for a period (usually a year).	Operating income (excluding amounts received specifically for new or upgraded assets and physical resources received free of charge) less operating expenses for the reporting period. Operating income = \$48.3 M Operating expenses = \$47.2 M Operating Surplus = \$1.1 M [48.3 – 47.2 = 1.1]	Breakeven operating position, or better over any five year period.
What does it Mean?		<p>If an entity is not generating an operating break-even result or better on average over the medium term it is unlikely to be operating sustainably. It means that the cost of goods produced and sold or services provided to the community exceed income generated.</p> <p>If an entity is operating with a significant deficit over several years and its strategic management and long term financial plans do not provide clear proposals for this to be turned around, then it is inevitable that it will face major financial shocks in the future. The entity is living beyond its means. Sooner or later, the entity will be caught by the consequences.</p>		

Indicator	Description	Comment	Calculation (\$M)	Indicative Target
6. Net Financial Liabilities	What is owed to others less money held, invested or owed to the entity.	Net financial liabilities equals total liabilities less financial assets.	<p>Total liabilities less financial assets (cash and cash equivalents + trade & other receivables + other financial assets).</p> <p>Total liabilities = \$15.7 M</p> <p>Cash & cash equivalents = \$2.2 M</p> <p>Trade & other receivables = \$1.0 M</p> <p>Other financial assets = \$0.9 M</p> <p>Net Financial Liabilities = \$11.6 M $[15.7 - (2.2 + 1.0 + 0.9) = 11.6]$</p>	<p>Net financial liabilities are between zero and annual operating income.</p> <p>Target range should be set having regard for the target for the entity's operating surplus ratio and needs identified in its strategic, long-term financial and asset management plans.</p>
<p>What does it Mean?</p> <p>As well as borrowings this indicator considers the entity's other liabilities and financial assets.</p> <p>Councils with significant asset funding needs may find their financial sustainability is improved by raising debt to fund these needs, especially where the operational savings achieved from addressing asset funding needs exceed the additional interest costs resulting from the debt raised.</p>				
7. Interest Cover Ratio	The proportion of day to day income used to pay interest on loans net of interest income.	Indicates the extent to which an entity's operating income is committed to meet net interest expenses.	<p>Net annual interest expense divided by operating income.</p> <p>Finance Cost = \$0.5 M</p> <p>Investment income = \$0.2 M</p> <p>Total operating income = \$48.3 M</p> <p>Interest Cover Ratio = 1% $[(0.5 - 0.2) / 48.3 = 1\%]$</p>	<p>Net interest is between 0% and 10% of operating income.¹⁸</p> <p>Target should be set in conjunction with targets for indicators 3 and 4.</p>
<p>What does it Mean?</p> <p>As with all indicators associated with measuring indebtedness and associated costs, there is no right or wrong ratio.</p> <p>An entity needs to manage this ratio within a range acceptable to it, having regard to its long term financial sustainability and strategic management plans and financial management policies.</p>				

¹⁸ Note: NSW LGI – target 15% (range 7% - 20%), Access Economic (Tas Report) suggested target range of 2% - 5% of own source income (not total income).

Indicator	Description	Comment	Calculation (\$M)	Indicative Target																				
8. Asset Consumption Ratio	The average proportion of 'as new condition' left in assets.	Shows the depreciated replacement cost of an entity's depreciable assets less their residual value relative to their depreciable amount.	<p>Depreciated replacement cost (DRC) of plant and equipment and infrastructure assets less residual value (RV) divided by depreciable amount (DA) of depreciable assets.</p> <table><tr><td>Asset class</td><td>DRC (M)</td><td>RV* (M)</td><td>DA* (M)</td></tr><tr><td>Buildings</td><td>\$34.2</td><td>\$10.2</td><td>\$39.9</td></tr><tr><td>Infrastructure</td><td>\$254.4</td><td>\$60.0</td><td>\$301.0</td></tr><tr><td>P&E & F&F</td><td>\$7.3</td><td>\$3.1</td><td>\$7.1</td></tr><tr><td>Total</td><td>\$295.9</td><td>\$73.3</td><td>\$348.0</td></tr></table> <p>Asset Consumption Ratio = 64% [(295.9-73.3) / 348.0 = 64%]</p> <p>*Not disclosed in financial statements but should be available from entity's records. Amount above has been assumed for illustrative purposes.</p>	Asset class	DRC (M)	RV* (M)	DA* (M)	Buildings	\$34.2	\$10.2	\$39.9	Infrastructure	\$254.4	\$60.0	\$301.0	P&E & F&F	\$7.3	\$3.1	\$7.1	Total	\$295.9	\$73.3	\$348.0	<p>Asset consumption ratio is between 40% and 80%.</p> <p>Target to be set having regard for the relative age and replacement/renewal profile of the entity's asset portfolio.</p>
Asset class	DRC (M)	RV* (M)	DA* (M)																					
Buildings	\$34.2	\$10.2	\$39.9																					
Infrastructure	\$254.4	\$60.0	\$301.0																					
P&E & F&F	\$7.3	\$3.1	\$7.1																					
Total	\$295.9	\$73.3	\$348.0																					
What does it Mean?		<p>This ratio seeks to highlight the aged condition of an entity's stock of physical assets.</p> <p>If an entity is responsibly maintaining and renewing/replacing its assets in accordance with a well prepared asset management plan, then the fact that it's Asset Consumption Ratio may be relatively low and/or declining should not be a cause for concern – providing it is operating sustainably.</p> <p>It makes no sense to replace perfectly serviceable assets, just because they are old. In such circumstances, the decline in the value of an entity's physical assets will be offset by a reduction in its net financial liabilities (either by an increase in its financial assets or preferably wherever possible, a reduction in its debt) as result of operating income generated being sufficient to cover its depreciation expense. Its Statement of Financial Position overall will be unaffected and it will be in a strong financial position and able to fund the future renewal/replacement of these assets when optimal to do so.</p>																						

Where an organisation has a well researched long-term financial plan that is based on future asset management funding needs it can calculate measures of future financial sustainability using the indicators in Table 2.6.1.2 based on the long-term financial plan's data.

A key performance criterion based on the above general principle could for example be as follows;

Historic and projected forward 10 year operating income must equal or exceed operating expenses for the same period.

Simplistically (and ignoring the effects of movements in specific prices¹⁹) an organisation that ensures operating income at least matches operating expenses will generate sufficient funds from depreciation of its assets to fund their replacement. Projected available operating income for asset renewal and replacement can therefore be thought of as equivalent to the depreciation expense for the period less any net operating deficit for the same period. (A council may in fact target achieving an operating surplus to help fund asset replacement backlogs or acquisition of additional assets without recourse to an increase in net financial liabilities).

Note, regular revaluation of assets to offset the effects of movements in specific prices (and other factors that affect value) is essential in order to accurately measure asset consumption. It will also help ensure funds generated more closely match asset replacement needs. Technological advances can result in some assets costing less to replace than originally provide. Typically, though organisations will need to achieve a small surplus on average over time in order to offset the effects of movements in specific prices on its capacity to internally fund asset renewal and replacement.

This effectively assumes that cash related expenses and non-cash related expenses other than depreciation are given priority in being accommodated from operating income. This reflects common traditional practice in local government. Any organisation that incurs ongoing operating deficits should be quite clear about the strategic implications of this on its future capabilities to sustain current service levels and indeed potentially as a going concern.

The pattern of required asset renewals will be uneven, even over different 10 year periods. It is possible therefore that even where an organisation has achieved an operating breakeven result for a 10 year period, actual funds required for asset renewal for the same period may be greater or less than available operating income generated.

An organisation that has little in the way of renewal and replacement expenditure needs during some periods may elect to utilise available operating income in excess of renewal needs to repay debt or finance new capital works. In so financing new capital works, it should recognise it is therefore likely that it will need to raise similar amounts in loans in future to meet asset replacement needs and should ensure its projected income can fully accommodate the additional operating costs (including depreciation) arising from the expansion in physical assets.

An organisation that has more significant renewal expenditure needs during some periods than can be accommodated from operating income may cost effectively elect to borrow funds (subject to the implications for its ongoing financial sustainability). It can repay such borrowings in future from funds generated from available operating income (ie by ensuring aggregate operating income matches or exceeds aggregate operating expenses including depreciation).

¹⁹ Note: Movement in specific prices allows for increases in prices of goods and services specific to an organisation. This is a different measure to movements in the general level of prices, commonly known as 'inflation'.

Achieving a sustainable position will require the development of several levels of service, risk and cost scenarios and consideration of the external environments which could include but not be limited to the following:

- population/demographic changes,
- carbon trading:
 - increase in costs for transport of materials and energy purchases,
 - shift towards local production and distribution of goods and produce,
- climate change:
 - availability of water supply,
 - hydrological change in stormwater runoff,
- oil price increases:
 - increase in cost for bitumen and other oil based products,
 - reduced supply of bitumen products,
 - greater demand for lower cost public transport systems.

2.6.2 Grants, Subsidies and Contributions

Grants and subsidies can include:

- operating grants such as the Commonwealth Government's Financial Assistance grants (both general purpose and local road component) and Roads to Recovery grants,
- grants paid to an entity specifically for renewal/replacement of existing assets,
- amounts paid to an entity specifically for the acquisition or construction of new or upgraded assets such as a swimming pool or library.

Contributions can include:

- physical resources generally constructed by others and received (contributed) free of charge such as roads, drainage systems, buildings and other services provided for new subdivisions.

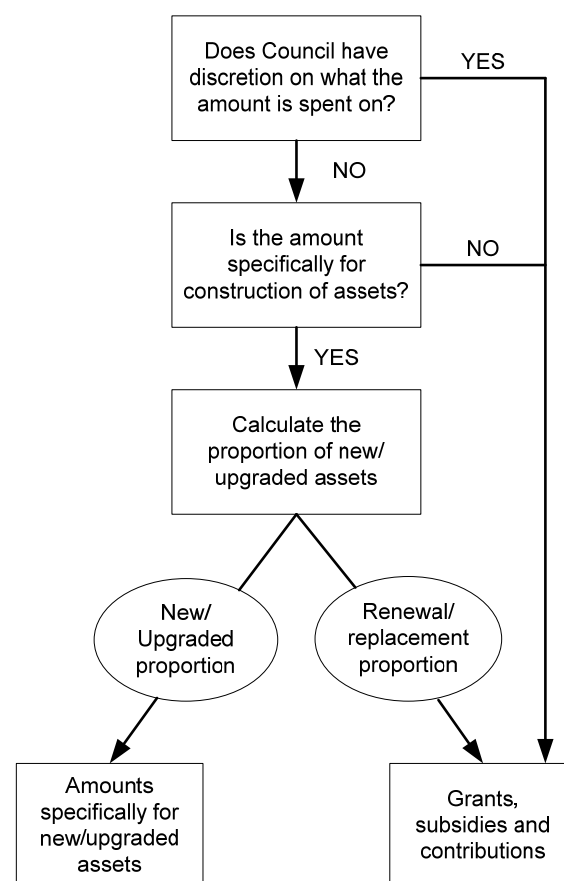
Grants, subsidies and contributions which are available to the entity to use at their discretion are reported in the hypothetical Council Statement of Comprehensive Income shown as Table 2.6.1 as part of operating income.

Grants and other amounts received specifically for new or upgraded assets are excluded from operating income and reported separately in the Statement of Comprehensive Income (after the operating result).

Contributions of physical resources received free of charge are also reported separately in the Statement of Comprehensive Income after the operating result.

Fig 2.6.2 gives a guide to identify amounts received specifically for new or upgraded assets.

Fig 2.6.2: Identifying Amounts for New/Upgraded Assets



Source: LGA 2010, p 39

These Guidelines recommend that amounts received specifically for new/upgraded assets and physical resources received free of charge are excluded from grants, subsidies and contributions (under operating income) and instead are reported separately in the Statement of Comprehensive Income.

This practice has already been adopted in some jurisdictions which require entities to show amounts received for new/upgrade assets and for contributions (sometimes referred to as "capital" income) separate from operating income in the Statement of Comprehensive Income.

The current wording of accounting standards do not address the need to separately disclose operating income and “capital” income, which are not terms defined by these standards.

However, AASB 101 *Presentation of Financial Statements* states in paragraph 5 that ‘if entities with not-for-profit activities in the private sector or the public sector apply this Standard, they may need to amend the descriptions used for particular line items in the financial statements and for the financial statements themselves.’

AASB 101 further states at paragraph 17 that to achieve a fair presentation the entity may need to provide additional disclosures when compliance with the specific requirements in Australian Accounting Standards is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

Paragraph 86 of AASB 101 also states that ‘because the effects of an entity's various activities, transactions and other events differ in frequency, potential for gain or loss and predictability, disclosing the components of financial performance assists users in understanding the financial performance achieved and in making projections of future financial performance. An entity includes additional line items in the statement of comprehensive income and in the separate income statement (if presented), and it amends the descriptions used and the ordering of items when this is necessary to explain the elements of financial performance. An entity considers factors including materiality and the nature and function of the items of income and expense’.

Assessments of an entity's financial performance and position including calculation of key financial sustainability indicators, requires income to be differentiated as either operating income including grants for renewal of existing assets or “capital” income including amounts received specifically for new/upgraded assets and physical resources received free of charge.

Where a project for which grant funding is received, includes both the renewal or replacement of existing assets and the acquisition or construction of new or upgraded assets, the income amount needs to be apportioned between each component. The proportion of income that is attributable to renewal/replacement of assets is operating income.

The apportionment between renewal/replacement and new/upgrade can be made in proportion to the estimated expenditure of the project as shown in Table 2.6.2.1.²⁰

Table 2.6.2.1: Project cost apportionment to Renewal and New

Estimated Cost	\$
Total cost of project	2.5M
Renewal/replacement components	1.5M
New/upgraded components	1.0M

Amount received	1.75M
Apportioned to <i>grants, subsidies and contributions</i> [1.75M / 2.5M x 1.5M]	1.05M
Apportioned to <i>amounts received specifically for new/upgraded assets</i> [1.75M / 2.5M x 1.0M]	0.70M

²⁰ LGA, 2008, pp 34-36.

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SECTION 5

FINANCIAL PLANNING

Key Points

Long-term financial planning is critical for organisations that have very large stocks of assets relative to their income base. It assists them to undertake asset renewal and replacement when required and achieve their affordable service level objectives.

A financial plan is a plan for generating, spending and saving future income and raising and repaying borrowings as necessary and appropriate. A financial plan seeks to efficiently and equitably accommodate ongoing funding of:

- existing services - operations, maintenance, asset renewal and asset upgrade and proposed variations thereto
- new services and assets as required or preferred.

Each year, decisions are made regarding the quantum and nature of income sought to be raised in annual budgets and intended operating outlays and capital works activity. These decisions should carefully consider the content of the long-term financial plan, its under-pinning financial strategy and the likely consequences of departing from the plan's proposals.

Work undertaken in the preparation of a long-term financial plan allows an organisation to:

- model the financial implications of a variety of service level and income raising scenarios,
- determine a combination of proposals that best meets the service level needs and preferences of its customers and/or stakeholder community in an equitable manner over time, while also
- ensuring the organisation's ongoing financial sustainability and service generating capacity.

A long-term financial plan should be reviewed and updated annually.

Core Approach

A basic long-term financial plan:

- is for a period of at least 4 years,
- takes into account the organisation's strategic planning documents,
- is based on a strategy that supports the organisation's financial sustainability,
- makes appropriate allowance for best estimate asset management needs, and
- is reviewed and updated annually.

Advanced Approach

The long-term financial plan:

- is recommended to be for a period of 10 years or more,
- is based on achievement of and discloses projected performance against carefully developed financial sustainability targets,
- fully accommodates in quantum and timing all activities identified as warranted in an asset management plan,
- includes a sensitivity analysis highlighting key factors or assumptions most likely to impact on the achievement of the plan's financial targets, and
- is reviewed and updated annually.

5.1 Introduction

The preparation of a long-term financial plan (LTFP) requires an organisation to think beyond the one year annual budget planning horizon. It guides planning for future activity.

What is a Long-Term Financial Plan?

A long-term financial plan is a plan for generating, spending and saving future income and raising and repaying borrowings as appropriate. It will cover a period of at least 4 years but preferably longer and will highlight the financial implications of an entity's proposed activities and anticipated events.

A long-term financial plan will usually be in a less detailed form than an organisation's annual budget but should nevertheless clearly enable the financial implications of intended outlays and anticipated incomes to be readily identified and proposals regarding service levels and income raising changed if necessary to meet its capabilities and circumstances.

Many not-for-profit infrastructure based organisations traditionally do not have formal, articulated long-term financial plans. Because such organisations often receive and/or control a reliable source of income and have had reasonably predictable and consistent annual outlays many historically saw little need for long-term financial planning – particularly in an era where their infrastructure assets were on average reasonably new and requiring little maintenance.

The reality is that long-term financial planning is critical for organisations that have very large stocks of assets relative to their income base. Without such planning, they are likely to struggle to be able to accommodate asset renewal and replacement when required – particularly in circumstances where annual income budgets are set based on offsetting cash costs (ie not raising income to offset depreciation).

While they could arguably borrow to finance such activity, the magnitude of required funds is likely to mean not all required works will be undertaken and this will have a detrimental impact on future costs and/or service levels.

Infrastructure assets are long-lived. Their maintenance costs may be quite low early in their lives but often can be expected to increase as the assets age.

However, in such cases, without a long-term financial plan an organisation is more likely to set operating income targets at levels based on initial low maintenance costs for infrastructure. It may then find it hard to increase operating income at the rate required as assets age and require more maintenance.

Long-Lived Infrastructure



Sluice Gates Torrens Weir, Adelaide, SA, 1929

The absence of a long-term financial plan is also likely to allow an organisation to over-invest in additional or upgraded assets and attempt to provide higher standards of service relative to what can be sustained with its existing income base.

An over-investment is also more likely where budgets are based on cash rather than accrual accounting and the full lifecycle costs of owning and operating an asset are not factored into decisions.

5.2 Long-Term Financial Plans

A Plan Needs a Strategy

A long-term financial plan needs to be underpinned by a clear financial strategy with measureable financial targets.

Section 2 of these Guidelines highlighted that for an organisation to be sustainable, it needs to be able to maintain its operating capacity and physical capital. An asset management plan may be prepared with this objective in mind. However, a long-term financial plan also needs to be prepared in order to identify the affordability implications of the service standards that underpin any asset management plan.

The long-term financial plan may therefore identify a need to plan to reduce in an orderly, strategic way the level of service able to be generated from assets, unless it can generate more income. For example it may highlight to a rural council that it may not be able to afford

to resheet its unsealed road network as often as it would prefer.

Being unaware of, or failing to face up to, this likelihood won't make the problem go away. It will just increase the probability of the consequences being more severe than they need have been when reactive decision-making is ultimately necessary.

Long-Term Service Objectives

A long-term financial plan should be based on an organisation achieving its affordable service level objectives while also maintaining, or where necessary improving, its financial sustainability.

Organisations need to determine financial targets appropriate for their circumstances. For example, Table 2.6.1 in Section 2 highlights financial indicators and recommended targets that have been developed and endorsed by the South Australian local government sector to support financial sustainability.

The most critical indicator of financial sustainability is an organisation's operating result shown in its Statement of Comprehensive Income, ie the difference between operating income and operating expenses expressed on an accrual basis.

If an organisation can maintain on average an operating breakeven result or better over the medium to longer term, looking backwards and forwards, it will be operating on a sustainable basis. Even so, it may not always have sufficient internally generated cash to fund asset/renewal and replacement as and when it falls due.

In such circumstances, it is likely though to have the capacity to borrow to the extent necessary for such purposes without significant additional future income raising need or adversely affecting its future financial sustainability.

Where an organisation needs to take steps to improve its financial sustainability its proposed responses should be incorporated into its long-term financial plan.

For example, an organisation with a significant operating deficit may conclude that it needs to

work on progressively eliminating this deficit over time. Its long-term financial plan could be based on small real (ie over and above inflation) annual increases in operating income, eg by raising taxes or user charges, while maintaining but not increasing service levels, and ensuring that operating expenses do not increase in real terms.

The cumulative compounding effect of modest initiatives maintained over the medium term can be quite significant – an additional increase in council rates by a local government for example of 0.5% pa over 10 years will mean that at the end of 10 years it will have collected 28% more rate income and even if after that time it applies no further increases it will still receive 5% more rate income every year thereafter.

Long-Term Financial Targets

A long-term financial plan should include a description of the financial strategy that the plan is based on including its financial targets and their rationale.

5.3 Duration of a Long-Term Financial Plan

There is no single right answer as to the period that a long-term financial plan should cover. For some organisations, the level of uncertainty concerning their operating environments and incomes and expenses beyond the next few years may mean that there is little additional benefit in attempting to prepare a longer financial plan.

Some organisations have not traditionally financially planned beyond the time frame of their annual budget. Preparing financial projections for even say a 4 year period is likely to generate valuable information, not only for financial decisions but also to highlight possible organisational development and peak project management needs.

The further out in time for which financial projections are made the less reliable and accurate they are likely to be.

Organisations that have a reasonably secure and predictable operating income stream and/or have a large share of their operating expenses generated from owning and operating long-lived infrastructure assets, should be able to plan with more certainty over a longer period. Regardless, it should be made explicitly clear in any plan, that the proposals upon which the financial projections are based, are not firm commitments but best estimates and preferences based on current available information.

Reviewing Long-Term Financial Plans

A long-term financial plan should be reviewed and updated annually or more often if specific developments so warrant.

South Australian local governments are required to prepare long-term financial plans of at least 10 years duration and these guidelines recommend such a period for other similar entities.

5.4 Format and Content of a LTFP

All public companies and many public sector organisations are required to prepare their end of year financial statements in a form consistent with Australian Accounting Standards. Many other entities are also required or elect to do so. Use of a well developed standardised format for reporting by an entity enables its stakeholders and other informed readers to readily and objectively assess its financial performance and position and compare these results with those of other entities.

Australian Accounting Standards require the preparation of a Statement of Financial Position, Statement of Comprehensive Income, Statement of Cash Flows and Statement of Change in Equity.

An emerging trend in public sector accounting standards is for them to require consistency between the content and format of published budgeted statements and that required for end of period reported financial statements.¹

¹ AASB 2008-9, *Amendments to AASB 1049 for consistency with AASB 101*, Sep 2008.

It makes sense for an organisation that needs to publicly disclose its annual budget to prepare a summary of its budget in the same form as the Australian Accounting Standards end of year financial statements even though more detailed and different format information may be prepared for internal management control purposes.

Likewise such organisations should produce summary long-term financial plan information in the Australian Accounting Standards financial reporting format in addition to any more detailed and supporting information format it requires or believes appropriate. For example it may see merit in also producing long-term financial plan data in the same format as its published, summary level annual budget papers which might express data on a functional basis (for example roads, waste management, parks and gardens etc).

Template formats that South Australian local governments are required to populate and publish in their long-term financial plans are shown in Section 14.2 as Tables 14.2.1 – 14.2.5.

In addition to the Australian Accounting Standard financial reporting based templates (Tables 14.2.2 – 14.2.5), South Australian local governments are also required to prepare a summary statement highlighting for each of the 10 years of the plan the following forecasts (refer Table 14.2.1):

- operating result
- net outlays on existing assets
- net outlays on new and upgraded assets
- net lending/borrowing
- summary of financing transactions
- results for key financial indicators

A long-term financial plan should also disclose detail about activities, service levels and assumptions upon which it has been based and other reasons why income and expenses are predicted to change over time. The following are examples of the types of information that should be listed:

- additional proposed services or variations in the quality or quantity of existing services and the associated financial (distinguishing between capital and operating income and expense) impacts. Ideally major new capital works should be



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Note: The Tables below do not cover all developments in the Law and Financial Reporting Standards issued during the year ending 31 December 2011.

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Recently Issued AASB Standards and Exposure Drafts

During 2011 there has been a deluge of accounting standards issued by the AASB as well as a number of the proposed changes. While some of the more substantive standards have a formal operative date a couple of years hence, it is well worth starting to understand the key elements of these standards. There are implications in terms of the third balance sheet, information gathering, systems issues and communication with stakeholders.

The AASB has recently approved the following Standards:

Effective from 1 July 2011

AASB 2011-5 'Extending Relief from Consolidation, the Equity Method and Proportionate Consolidation'

Effective from 1 July 2012

AASB 2011-9 'Amendments to Australian Accounting Standards – Presentation of Items of Other Comprehensive Income'

Effective from 1 January 2013

AASB 10 'Consolidated Financial Statements'

AASB 11 'Joint Arrangements'

AASB 12 'Disclosure of Interests in Other Entities'

AASB 127 'Consolidated and Separate Financial Statements'

AASB 128 'Investments in Associates and Joint Ventures'

AASB 2011-7 'Amendments to Australian Accounting Standards arising from the Consolidation and Joint Arrangements Standards'

AASB 13 'Fair Value Measurement'

AASB 2011-8 'Amendments to Australian Accounting Standards arising from AASB 13'

AASB 119 'Employee Benefits'

AASB 2011-10 'Amendments to Australian Accounting Standards arising from AASB 119' (Sept 2011)

Effective from 1 July 2013

AA SB 2011-6 'Extending Relief from Consolidation, the Equity Method and Proportionate Consolidation – Reduced Disclosure Requirements', and

AASB 2011-11 'Amendments to AASB 119 (September 2011) arising from Reduced Disclosure Requirements'.

Also the AASB has issued the following exposure drafts:

ED 214 'Extending Related Party Disclosures to the Not-for-Profit Public Sector'

Recently Issued AASB Standards and Exposure Drafts

ED 215 'Mandatory Effective Date of IFRS 9'
 ED 216 'AASB 12 Disclosure of Interests in Other Entities: Tier 2 Proposals'
 ED 217 'AASB 127 Separate Financial Statements: Tier 2 Proposals'
 ED 218 'Presentation of Items of Other Comprehensive Income: Tier 2 Proposals'
 ED 219 'AASB 13 Fair Value Measurement' and AASB 2011-8 'Amendments to Australian Accounting Standards arising from AASB 13': Tier 2 Proposals'
 ED 220 'Investment Entities (incorporating IASB E D/2011/4)', and
 ITC 25 Request for Comment on 'IASB Request for Views on Agenda Consultation 2011'.

Within the next twelve months, it is expected that a financial instruments standard will be completed, and that new revenue standards and a new exposure draft on leasing will be issued by the IASB. On the domestic front, we will see the Australian version of IASB 'Conceptual framework – Phase A: objective and qualitative characteristics', more on the reduced disclosure regime, and application of the reporting entity.

Standards effective from 1 January 2013 have a transition date of 1 January 2012.

Each of these standards and exposure drafts is briefly explained in this Update.

New/Amended Accounting Standards

Relief from Consolidation, Equity Method and Proportionate Consolidation

Pronouncement:

[AASB 2011-5 'Extending Relief from Consolidation, the Equity Method and Proportionate Consolidation'](#)
[AASB 2011-6 'Amendments to Australian Accounting Standards – Extending Relief from Consolidation, the Equity Method and Proportionate Consolidation – Reduced Disclosure Requirements'](#)

Applies to:

AASB 2011-5 'Amendments to Australian Accounting Standards – Extending Relief from Consolidation, the Equity Method and Proportionate Consolidation-7; applies to annual reporting periods beginning on or after 1 July 2011 and can be adopted early for periods beginning on or after 1 January 2005. AASB 2011-6 'Amendments to Australian Accounting Standards – Extending Relief from Consolidation, the Equity Method and Proportionate Consolidation – Reduced Disclosure Requirements' applies to annual reporting periods beginning on or after 1 July 2013 and can be adopted early for periods beginning on or after 1 July 2009 provided that AASB 1053 is also adopted early for the same period.

Summary:

The AASB issued two Amending Standards to extend relief from consolidation, the equity method and proportionate consolidation to not-for-profit entities and Tier 2 entities in particular circumstances. This builds on the de-regulation of general purpose financial reporting introduced through AASB 1053 'Application of Tiers of Australian Accounting Standards' in 2010 and the AASB expects Tier 2 entities to be the main beneficiaries of the relief.

In common with their IFRS counterparts, AASB 127 'Consolidated and Separate Financial Statements', AASB 128 'Investments in Associates' and AASB 131 'Interests in Joint Ventures' already provide relief from consolidation, the equity method and proportionate consolidation for entities that satisfy certain criteria, including having an ultimate or intermediate parent that produces consolidated financial statements available for public use that are compliant with IFRS. The Amending Standards make that relief generally available in corresponding circumstances where the ultimate or intermediate parent applies not-for-profit Aus paragraphs in Australian IFRSs as adopted in Australia, or Australian Accounting Standards – Reduced Disclosure Requirements (RDR).

New/Amended Accounting Standards

The Chairman, Kevin Stevenson, commented that “the AASB believes it’s appropriate to provide entities that comply with Australian Accounting Standards (including Aus paragraphs applicable to not-for-profit entities) or Australian Accounting Standards-Reduced Disclosure Requirements with effectively the same relief that is available to entities that are IFRS-compliant.”

AASB 2011-5 introduces the relief from consolidation for not-for-profit entities and AASB 2011-6 does so for Tier 2 entities. For example, under the Amending Standards, a not-for-profit parent would be relieved from preparing consolidated financial statements if it had an ultimate not-for-profit parent that produces consolidated financial statements complying with Australian Accounting Standards available for public use, provided all the other relevant criteria are met. Similarly, a for-profit Tier 2 parent would be relieved from preparing consolidated financial statements if it had an ultimate Tier 2 parent that complies with Australian Accounting Standards – Reduced Disclosure Requirements.

The AASB considers that the relief from consolidation, the equity method and proportionate consolidation should also be available in certain circumstances to a parent entity, investor or venturer where the ultimate or any intermediate parent entity prepares consolidated financial statements that are not compliant with IFRS. Therefore, this Standard extends that relief provided that the parent entity, investor or venturer:

- (a) is a not-for-profit entity complying with Australian Accounting Standards,
- (b) has an ultimate or intermediate parent that is also a not-for-profit entity that prepares consolidated financial statements in accordance with Australian Accounting Standards, and
- (c) meets the relevant criteria in AASB 127, AASB 128 or AASB 131.

Accordingly, this Standard extends the relief from consolidation, the equity method and proportionate consolidation by removing the requirement for the consolidated financial statements prepared by the ultimate or any intermediate parent entity to be IFRS compliant, provided that the parent entity, investor or venturer and the ultimate or intermediate parent entity are not-for-profit entities that comply with Australian Accounting Standards.

This approach is based on the view that financial statement users would be able to satisfy their information needs through the consolidated financial statements prepared by the parent higher up in the group.

Other Comprehensive Income

Pronouncement:

[AASB 2011-9 ‘Amendments to Australian Accounting Standards – Presentation of Items of Other Comprehensive Income’](#)

Applies to:

Annual reporting periods beginning on or after 1 July 2012, and early adoption is permitted.

Summary:

The AASB issued AASB 2011-9 ‘Amendments to Australian Accounting Standards – Presentation of Items of Other Comprehensive Income’. The main change resulting from the amendments relates to the ‘Statement of Profit or Loss and Other Comprehensive Income’ and is a requirement for entities to group items presented in other comprehensive income on the basis of whether they are potentially reclassifiable to profit or loss subsequently (reclassification adjustments).

Other comprehensive income comprises items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by other Australian Accounting Standards.

New/Amended Accounting Standards

The components of other comprehensive income include:

- (a) changes in revaluation surplus (see AASB 116 *Property, Plant and Equipment* and AASB 138 *Intangible Assets*),
- (b) actuarial gains and losses on defined benefit plans recognised in accordance with paragraph 93A of AASB 119 *Employee Benefits*,
- (c) gains and losses arising from translating the financial statements of a foreign operation (see AASB 121 *The Effects of Changes in Foreign Exchange Rates*),
- (d) gains and losses on remeasuring available-for-sale financial assets (see AASB 139 *Financial Instruments: Recognition and Measurement*), and
- (e) the effective portion of gains and losses on hedging instruments in a cash flow hedge (see AASB 139).

The amendments do not remove the option to present profit or loss and other comprehensive income in two statements. AASB 2011-9 incorporates amendments to IAS 1 'Presentation of Financial Statements' recently issued by the IASB, and therefore ensures that AASB Standards and IASB Standards continue to align. Publicly accountable (Tier 1) for-profit entities that comply with AASB 2011-9 will simultaneously be in compliance with IAS 1.

Kevin Stevenson, Chairman of the AASB, said "These changes are a step forward in clarifying the nature of items included in other comprehensive income. However, the changes do not address the underlying issue of which income and expense items should be included in other comprehensive income, as distinct from profit or loss. The AASB considers a fundamental review of the nature of other comprehensive income is required, and intends expressing this in its response to the IASB's Agenda Consultation request for views, which is currently open for comment."

The AASB will consider the relief from certain disclosure requirements that should be provided to entities that adopt Tier 2 Reduced Disclosure Requirements through a separate due process.

The main change resulting from the amendments is a requirement for entities to group items presented in other comprehensive income (OCI) on the basis of whether they are potentially reclassifiable to profit or loss subsequently (reclassification adjustments). These amendments do not remove the option to present profit or loss and other comprehensive income in two statements.

Consolidated Financial Statements

Pronouncement:

[AASB 10 'Consolidated Financial Statements'](#)

Applies to:

This Standard applies to both for-profit and not-for-profit entities. However, prior to the 1 January 2013 mandatory application date of this Standard, the AASB will consider whether this Standard should be modified for application by not-for-profit entities having regard to its *Process for Modifying IFRSs for PBE/NFP*. In light of this, **not-for-profit entities are not permitted to apply this Standard prior to the mandatory application date.**

Summary:

The objective of AASB 10 is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. To meet this objective this Standard:

- (a) requires an entity (the parent) that controls one or more other entities (subsidiaries) to present consolidated financial statements;
- (b) defines the principle of control, and establishes control as the basis for consolidation;
- (c) sets out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee; and

New/Amended Accounting Standards

(d) sets out the accounting requirements for the preparation of consolidated financial statements.

AASB 10 does not deal with the accounting requirements for business combinations and their effect on consolidation, including goodwill arising on a business combination (see AASB 3 *Business Combinations*).

Joint Arrangements

Pronouncement:

[AASB 11 'Joint Arrangements'](#)

Applies to:

Both for-profit and not-for-profit entities. However, prior to the 1 January 2013 mandatory application date of this Standard, the AASB will consider whether this Standard should be modified for application by not-for-profit entities having regard to its *Process for Modifying IFRSs for PBE/NFP*. In light of this, **not-for-profit entities are not permitted to apply this Standard prior to the mandatory application date.**

Summary:

Standard AASB 11 shall be applied by all entities that are a party to a joint arrangement, which is either a *joint operation* or a *joint venture*. A joint arrangement is an arrangement of which two or more parties have joint control and has the following characteristics:

- (a) The parties are bound by a contractual agreement; and
- (b) The contractual arrangement gives two or more of those parties joint control of the arrangement.

Disclosure of Interests in Other Entities

Pronouncement:

[AASB 12 'Disclosure of Interests in Other Entities'](#)

Applies to:

This Standard applies to both for-profit and not-for-profit entities. However, prior to the 1 January 2013 mandatory application date of this Standard, the AASB will consider whether this Standard should be modified for application by not-for-profit entities having regard to its *Process for Modifying IFRSs for PBE/NFP*. In light of this, **not-for-profit entities are not permitted to apply this Standard prior to the mandatory application date.**

Summary:

Standard AASB 12 requires an entity shall disclose information about significant judgements and assumptions it has made (and changes to those judgements and assumptions) in determining:

- (a) that it has control of another entity,
- (b) that it has joint control of an arrangement or significant influence over another entity; and
- (c) the type of joint arrangement (ie joint operation or joint venture) when the arrangement has been structured through a separate vehicle.

An entity shall also disclose information that enables users of its consolidated financial statements:

- (a) to understand the composition of the group and the interest that non-controlling interests have in the group's activities and cash flows ; and
- (b) to evaluate:
 - (i) the nature and extent of significant restrictions on its ability to access or use assets, and settle liabilities, of the group;
 - (ii) the nature of, and changes in, the risks associated with its interests in consolidated structured entities;
 - (iii) the consequences of changes in its ownership interest in a subsidiary that do not result in a loss of control; and
 - (iv) the consequences of losing control of a subsidiary during the reporting period.

New/Amended Accounting Standards

Also an entity shall disclose information that enables users of its financial statements to evaluate:

- (a) the nature, extent and financial effects of its interests in joint arrangements and associates, including the nature and effects of its contractual relationship with the other investors with joint control of, or significant influence over, joint arrangements and associates; and
- (b) the nature of, and changes in, the risks associated with its interests in joint ventures and associates.

Consolidated and Separate Financial Statements

Pronouncement:

[AASB 127 'Consolidated and Separate Financial Statements'](#)

Applies to:

This standard is to be superseded by AASB 10 and AASB 127 and applies to annual reporting periods beginning before 1 January 2013.

Summary:

Current requirements remain until superseded.

Separate Financial Statements

Pronouncement:

[AASB 127 'Separate Financial Statements'](#)

Applies to:

When applied or operative, this Standard, together with AASB 10, supersedes AASB 127 *Consolidated and Separate Financial Statements* (March 2008, as amended). This Standard will apply to annual reporting periods beginning after 1 January 2013.

Summary:

This Standard shall be applied in accounting for investments in subsidiaries, joint ventures and associates when an entity elects, or is required by local regulations, to present separate financial statements. This Standard does not mandate which entities produce separate financial statements. It applies when an entity prepares separate financial statements that comply with Australian Accounting Standards.

Interpretations of Standards

Pronouncement:

[AASB 1048 Interpretation of Standards](#)

Applies to:

Annual reporting periods ending on or after 31 December 2011, with specific application dates applicable to individual Interpretations.

Summary:

This is the service standard which makes the Interpretations effective – refer to the next list for changes in interpretations for this period.

Investments in Associates and Joint Ventures

Pronouncement:

[AASB 128 'Investments in Associates and Joint Ventures'](#)

Applies to:

Annual reporting periods beginning after 1 January 2013.

Summary:

This Standard shall be applied by all entities that are investors with joint control of, or significant influence over, an investee. This standard supersedes the existing AASB 128 'Investments in Associates' and the existing AASB 131 'Interests in Joint Ventures'

New/Amended Accounting Standards

Investments in Associates

Pronouncement:

[AASB 128 'Investments in Associates'](#)

Applies to:

This standard is to be superseded by AASB 128 'Investments in Associates and Joint Ventures' and will apply to annual reporting periods beginning before 1 January 2013.

Summary:

Current requirements remain until superseded.

Interests in Joint Ventures

Pronouncement:

[AASB 131 'Interests in Joint Ventures'](#)

Applies to:

This standard is to be superseded by AASB 128 'Investments in Associates and Joint Ventures' and will apply to annual reporting periods beginning before 1 January 2013.

Summary:

Current requirements remain until superseded.

Amendments to Australian Accounting Standards arising from the Consolidation and Joint Arrangements Standards

Pronouncements:

[AASB 2011-7 'Amendments to Australian Accounting Standards arising from the Consolidation and Joint Arrangements Standards'](#)

Applies to:

Standard applies to annual reporting periods beginning on or after 1 January 2013 and is applied when AASB 10, AASB 11, AASB 12, AASB 127 and AASB 128 are applied. Earlier application is permitted by for-profit entities, **but not by not-for-profit entities, for annual reporting periods beginning on or after 1 January 2005 but before 1 January 2013.**

Summary:

This Standard gives effect to many consequential changes arising from the issuance of the new Standards. For example, references to AASB 127 *Consolidated and Separate Financial Statements* are amended to AASB 10 *Consolidated Financial Statements* or AASB 127 *Separate Financial Statements*, and references to AASB 131 *Interests in Joint Ventures* are deleted as that Standard has been superseded by AASB 11 and AASB 128 (August 2011).

Measurement of Fair Value

Pronouncement:

[AASB 13 'Fair Value Measurement'](#)

[AASB 2011-8 'Amendments to Australian Accounting Standards arising from AASB 13'](#).

Applies to:

Annual reporting periods commencing from 1 January 2013.

Summary:

AASB 13 brings together, in a single source, guidance for all fair value measurements required in other Standards. It provides a clear definition of fair value, a framework for measuring fair value. AASB 13 incorporates IFRS 13 'Fair Value Measurement' recently issued by the IASB, and ensures that AASB Standards and IASB Standards continue to align. The enhanced disclosures in the Standard include disclosures about valuation techniques and the inputs used, and any additional information considered

New/Amended Accounting Standards

necessary for users to evaluate the quantitative information disclosed. Through a separate due process, the AASB will consider the relief from certain disclosure requirements that should be provided to entities that adopt Tier 2 Reduced Disclosure Requirements.

Kevin Stevenson, Chairman of the AASB, said "This standard rationalises and clarifies the measurement of fair value under accounting standards, but does not extend the use of fair value. It will be a vital source of guidance with which accountants will need to become quite familiar". This Standard assists with how to measure fair value, particularly when the market for an asset or liability becomes less active and users may require more information about the measurement uncertainty involved. Mr Stevenson said "The addition of this guidance is a direct response to questions raised during the global financial crisis when markets shut down overnight".

This Standard:

- (a) defines *fair value* as **Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.**;
- (b) sets out in a single Standard a framework for measuring fair value; and
- (c) requires disclosures about fair value measurements.

Fair value is a market-based measurement, not an entity-specific measurement. The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions.

When a price for an identical asset or liability is not observable, an entity measures fair value using another valuation technique that maximises the use of relevant observable inputs and minimises the use of unobservable inputs. Because fair value is a market-based measurement, it is measured using the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. As a result, an entity's intention to hold an asset or to settle or otherwise fulfil a liability is not relevant when measuring fair value.

The definition of fair value focuses on assets and liabilities because they are a primary subject of accounting measurement. In addition, this Standard shall be applied to an entity's own equity instruments measured at fair value.

This Standard applies to annual reporting periods beginning on or after 1 January 2013.

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This Standard may be applied to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2013. If an entity applies this Standard to such an annual reporting period, it shall disclose that fact. .

This Standard applies when another Standard requires or permits fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements), except as specified in paragraphs 6 and 7.

Employee Benefits

Pronouncements:

[AASB 119 'Employee Benefits'](#)

[AASB 2011-10 'Amendments to AASB 119 \(September 2011\) arising from AASB 119 \(Sept 2011\)'](#).

[AASB 2011-11 'Amendments to AASB 119 \(September 2011\) arising from Reduced Disclosure Requirements'](#).

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Applies to:

When applied or operative, this Standard supersedes AASB 119 Employee Benefits (December 2004, as amended).

Summary:

The AASB issued improvements to the accounting by employers for defined benefit plans through amendments to AASB 119 'Employee Benefits'. The changes apply to annual reporting periods beginning on or after 1 January 2013, and early adoption is permitted. The amendments to AASB 119 comprise: AASB 119 'Employee Benefits' (September 2011); AASB 2011-10 'Amendments to Australian Accounting Standards arising from AASB 119' (September 2011); and AASB 2011-11 Amendments to AASB 119 (September 2011) arising from Reduced Disclosure Requirements.

AASB 119 (September 2011) incorporates amendments to IAS 19 'Employee Benefits' recently issued by the IASB. Publicly accountable (Tier 1) for-profit entities that comply with AASB 119 (September 2011), and the consequential amendments to other Standards arising from it, will simultaneously be in compliance with IAS 19 (June 2011).

The main changes to accounting for defined benefit plans are:

- to eliminate the option to defer the recognition of gains and losses (the 'corridor method')
- requiring remeasurements to be presented in other comprehensive income, and
- enhancing the disclosure requirements relating to defined benefit plans for Tier 1 entities (the AASB has provided relief from certain disclosure requirements for entities that adopt Tier 2 Reduced Disclosure Requirements).

Kevin Stevenson, Chairman of the AASB, said: "These changes will provide greater clarity of the effect that defined benefit obligations have on an entity's financial statements, and will enhance comparability by eliminating options. Further, the requirement for remeasurements to be presented in other comprehensive income is an improvement to AASB 119. We are also pleased to release, concurrently with the amendments to AASB 119, the related Tier 2 reduced disclosure requirements. These amendments significantly reduce the disclosure burden for Tier 2 entities that have defined benefit obligations."

Definitions of Public Sector Entities

Pronouncements:

[AASB 101 Presentation of Financial Statements](#)

Applies to:

Applies to: financial reporting periods beginning or after 1 July 2009:

Summary:

The AASB has included in AASB 101 a new paragraph Aus7.2 In respect of public sector entities, *local governments*, *governments* and most, if not all, *government departments* are *reporting entities*: *reporting entity* means an entity in respect of which it is reasonable to expect the existence of users who rely on the entity's general purpose financial statement for information that will be useful to them for making and evaluating decisions about the allocation of resources. A reporting entity can be a single entity or a group comprising a parent and all of its subsidiaries.

government means the Australian Government, the Government of the Australian Capital Territory, New South Wales, the Northern Territory, Queensland, South Australia, Tasmania, Victoria or Western Australia.

government department means a government controlled entity, created pursuant to administrative arrangements or otherwise designated as a government department by the government which controls it.

local government means an entity comprising all entities controlled by a governing body elected or appointed pursuant to a Local Government Act or similar legislation.

Exposure Drafts released for Comments

Related Party Disclosures**Pronouncements:**

[ED 214 'Extending Related party Disclosures to the Not-for-Profit Public Sector'](#)

Applies to:

The AASB has proposed that NFP public sector entities apply AASB 124 with an effective date of 1 July 2013. Comments are due to the AASB by 31 January 2012.

Summary:

The Australian Accounting Standards Board (AASB) has issued [ED 214](#) *Extending Related Party Disclosures to the Not-for-Profit Public Sector*. Accounting Standard AASB 124 Related Party Disclosures presently does not apply to general purpose financial statements of not-for-profit (NFP) public sector entities.

Under the proposals, the requirements in AASB 124 would apply unamended to NFP public sector entities. Accordingly, certain transactions between government-related entities of the same jurisdiction would not be required to be disclosed in detail, and other related party transactions, such as Ministerial transactions, would only be disclosed if material.

"If the proposals proceed, it would bring the NFP public sector into line with other sectors of the economy that are already applying AASB 124. NFP public sector entities would have to disclose certain related party transactions and aggregated remuneration of key management personnel, which would benefit users of financial reports of NFP public sector entities," said Kevin Stevenson, Chairman of the AASB.

Effective Date for Financial Instruments Standard is extended to 1 January 2015**Pronouncement**

[ED 215 'Mandatory Effective Date of IFRS 9 Financial Instruments'](#)

Applies to:

The IASB issued amendments to IFRS 9 'Financial Instruments' that defer the mandatory effective date from 1 January 2013 to 1 January 2015. The AASB is expected to similarly defer AASB 9. The deferral will make it possible for all phases of the project to have the same mandatory effective date.

Summary:

The amendments also provide relief from the requirement to restate comparative financial statements for the effect of applying IFRS 9. This relief was originally only available to companies that chose to apply IFRS 9 prior to 2012. Instead, additional transition disclosures will be required to help investors understand the effect that the initial application of IFRS 9 has on the classification and measurement of financial instruments. Early application of IFRS 9 is still permitted.

Impact of Tier 2 Proposals**Pronouncements:**

[ED 216 'AASB 12 'Disclosures of Interests in Other Entities: Tier 2 Proposals'](#)

[ED 217 'AASB 127 'Consolidated and Separate Financial Statements: Tier 2 Proposals'](#)

[ED 218 'Presentation of Items of Other Comprehensive Income: Tier 2 Proposals'](#)

[ED 219 'AASB 13 Fair Value Measurement' and AASB 2011-8 'Amendments to Australian Accounting Standards arising from AASB 13': Tier 2 Proposals'](#)

Applies to:

Comment due to AASB at various dates in 2012.

Summary:

The purpose of these Exposure Drafts is to seek comment on the disclosure requirements that should apply to Tier 2 entities.

Exposure Drafts released for Comments

Investment Entities**Pronouncements:**

ED 220 'Investment Entities (incorporating IASB ED 2011/4

Applies to:

Comment due to AASB by September 2011

Summary:**Exclusion of investment entities from consolidation**

The exposure draft proposes that an investment entity (as defined) should be required to measure investments in entities that it controls at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments* rather than consolidating such investments.

Thus, the exposure draft proposes to create an exception to the principle of consolidation in IFRS 10 and thereby responds to the long-standing concern raised by many, including users of financial statements, that the consolidation of investments in controlled entities by investment entities does not provide information as useful as the information that would be provided by measuring the investments at fair value through profit or loss.

Criteria for determining when an entity is an investment entity

The Board believes that whether an entity is an investment entity should be determined on the basis of an overall consideration of the nature of the entity's transactions and its relationships with its investees and its external investors.

To assist in determining whether an entity is an investment entity the exposure draft proposes criteria and application guidance that an entity must satisfy to qualify as an investment entity. Paragraph 2 states that an investment entity is an entity that meets all of the following criteria:

- (a) The entity's only substantive activities are investing in multiple investments for capital appreciation, investment income (such as dividends or interest), or both [*nature of the investment activity*].
- (b) The entity makes an explicit commitment to a group of investors that the entity's purpose is investing to earn capital appreciation, investment income (such as dividends or interest), or both [*business purpose*].
- (c) Ownership in the entity is represented by units of investments, such as shares or partnership interests, to which proportionate shares of net assets are attributed [*unit ownership*].
- (d) The funds of the entity's investors are pooled so that the investors can benefit from professional investment management. The entity has investors that are unrelated to the parent (if any), and collectively hold a significant ownership interest in the entity [*pooling of funds*].
- (e) Substantially all of the investments of the entity are managed, and their performance is evaluated, on a fair value basis [*fair value management*].
- (f) The entity provides financial information about its investment activities to its investors. The entity can be, but does not need to be, a legal entity.

New International Valuation Standard

New International Valuation Standards Released

Pronouncement

The new International Valuation Standards (IVS) cover valuation of a wide range of assets – financial instruments, real property, intangible assets, and business interests.

Applies to:

The new IVS will be effective from January 2012.

Summary:

Responding to the recognition of the importance of valuation standards by global regulators, the International Valuation Standards Council (IVSC) published new International Valuation Standards. Capital markets need to have confidence in valuations, and following numerous inquiries into the 2008 financial crisis, regulators and the G-20 have acknowledged that proper valuation standards and effective regulation are necessary for improved financial stability. The overriding objective of the new IVS is to increase the confidence of users of valuation services in the valuations on which they rely.

The new IVS cover valuation of a wide range of assets – financial instruments, real property, intangible assets, and business interests. They are the result of a three year improvement project undertaken by the IVSC and have been subject to thorough international due process. They aim to promote consistency and transparency throughout the valuation process and include explanations of common valuation methods and principles, as well as procedures that valuation professionals should follow during the conduct of an assignment.

Steven Sherman, Chairman of the IVSC's Standards Board, commented "The new International Valuation Standards contain globally accepted concepts and principles for the delivery of valuations on which investors rely. Since valuation is key to financial decision making, whether for investment or for measuring performance throughout the financial system, an up to date and robust set of standards is needed to help eliminate avoidable risks". Michel Prada, Chairman of the IVSC Board of Trustees, commented "The financial crisis has provoked serious debate about the role and reliability of valuations and their impact on financial markets. The ambition of the IVSC is clear – to provide standards and guidance that improve the quality and reliability of valuations globally". Now more than ever, standardised valuation across all business sectors is vital for reducing investment risk, adding confidence to financial reporting and providing a consistent approach to portfolio and asset valuation", he concluded.

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Materiality being Examined

Pronouncement:

[Materiality in Financial Reporting – European Discussion Paper Issued :](#)

Summary:

The objective of financial statements is to provide information to a range of users for the purpose of economic decision making. To be useful, such statements must present fairly the financial position, performance and cash flows of the reporting entity. Where information which is required by the relevant financial reporting framework is omitted or misstated and such information could influence the economic decision-making of a user, financial statements cannot be said to achieve a fair presentation. The concept of 'materiality' is used to describe such information.

A recurring theme of discussions at the European Enforcers Coordination Sessions (a forum in which all European National Enforcers of financial information meet to exchange views and discuss experiences of enforcement of IFRS) is the apparent differing views regarding the practical application of the concept of materiality amongst preparers, auditors, possibly users of the financial reports and, in some instances, accounting enforcers. The purpose of this consultation paper is to seek comments from interested parties on their understanding of various aspects of materiality in an effort to contribute to a consistent application of this important concept in financial reporting.

Accounting for Water

Pronouncements:

[The Water Accounting Conceptual Framework \(WACF\)](#)

Summary:

The Conceptual Framework for the Preparation and Presentation of General Purpose Water Accounting Reports (**WACF**) comprises a *Preface* and eight *Statements of Water Accounting Concepts (SWAC)*. The primary purpose of the WACF is to guide the development of Australian Water Accounting Standards (**AWAS**) to ensure they remain cohesive and integrated.

However, preparers can draw on the WACF for principle based guidance in assisting the preparation and presentation of General Purpose Water Accounting Reports (**GPWARs**) where AWAS is not sufficient for their requirements.

Concept of the Water Entity

A water entity is a physical entity, an organisation or individual, which:

- a) holds or transfers water;
- b) has rights or other direct or indirect claims to water;
- c) has inflows and/or outflows of water; or
- d) has responsibilities relating to the management of water.

Concept of the Water Reporting Entity

A water reporting entity is a water entity in respect of which it is reasonable to expect the existence of users who depend on GPWARs for information about water, or rights or other claims to water, which shall be useful to them for making and evaluating decisions about the allocation of resources.

Preparation of General Purpose Water Accounting Reports

GPWARs prepared and presented in accordance with the Water Accounting Conceptual Framework and Australian Water Accounting Standards shall be prepared in relation to water reporting entities.

Concept of the Objective of General Purpose Water Accounting Reports

GPWARs shall provide information useful to users for making and evaluating decisions about the allocation of resources. To facilitate the provision of a complete set of information useful for making and evaluating decisions about the allocation of resources, GPWARs shall:

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- a) be prepared in a manner which assists users to evaluate accountability for the management of water resources;
- b) disclose information that assists users to assess compliance with relevant externally-imposed requirements or with broader notions of best practice relevant to water reporting entities; and
- c) include independent assurance to users as to whether the components of the reports are prepared and presented in accordance with the requirements of the Water Accounting Conceptual Framework, Australian Water Accounting Standards and other associated generally accepted water accounting practices and principles.

Concepts of the Qualitative Characteristics of General Purpose Water Accounting Reports

In order for GPWARs to satisfy their intended objective, the information contained in those reports shall possess qualitative characteristics, or attributes, that make the information useful to report users for making and evaluating resource allocation decisions.

The principal qualitative characteristics are relevance, faithful representation, comparability, verifiability, timeliness and understandability. Providing information in GPWARs satisfies the objective of usefulness is subject to materiality and cost constraints.

Elements of General Purpose Water Accounting Reports

The elements of GPWARs are:

- a) Water assets
- b) Water liabilities
- c) Net water assets
- d) Changes in water assets
- e) Changes in water liabilities

Water Assets

A water asset is water, or the rights or other claims to water, which the water reporting entity either holds, or for which the water reporting entity has management responsibilities, and from which an individual or organisation that is a water reporting entity, or a group of stakeholders of a physical water entity, derives future benefits.

Water Liabilities

A water liability is a present obligation of the water reporting entity, the discharge of which is expected to result in a decrease in the water reporting entity's water assets or an increase in another water liability.

Net Water Assets

Net water assets are the excess of the water assets of the water reporting entity after deducting all its water liabilities.

Changes in Water Assets

Changes in water assets are increases or decreases in the water reporting entity's water assets.

Changes in Water Liabilities

Changes in water liabilities are increases or decreases in the water reporting entity's water liabilities.

GPWARs shall report water assets, water liabilities, net water assets, and changes in water assets and changes in water liabilities when this information meets the objective of GPWARs

Recognition of the Elements of General Purpose Water Accounting Reports

Recognition is the process of recording elements of GPWARs in statements within those GPWARs. An item that meets the definition of a water asset shall be recognised in a particular statement within the GPWARs if:

- a) it is probable that future benefits associated with the item will be derived by the individual or

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organisation that is a water reporting entity, or by a group of stakeholders of a physical water entity that is a water reporting entity; and

- b) the item has an attribute that can be quantified with representational faithfulness; and
- c) the attribute that can be quantified with representational faithfulness is the appropriate unit of account for the particular statement.

An item that meets the definition of a water liability shall be recognised in a particular statement within the GPWARs if:

- a) it is probable that the obligation will result in a decrease in the water reporting entity's assets or an increase in another water liability when an obligation is discharged; and
- b) the item has an attribute that can be quantified with representational faithfulness; and
- c) the attribute that can be quantified with representational faithfulness is the appropriate unit of account for the particular statement.

An item that meets the definition of net water assets shall be recognised in a particular statement within the GPWARs if:

- a) the water assets and water liabilities giving rise to the net water assets are recognised in the general purpose water accounting report; and
- b) the item has an attribute that can be quantified with representational faithfulness; and
- c) the attribute that can be quantified with representational faithfulness is the appropriate unit of account for the particular statement.

An item that meets the definition of a change in a water asset or a change in a water liability shall be recognised in a particular statement within the GPWARs if:

- a) it is probable that there has been a change in a water asset or a change in a water liability; and
- b) the water asset or water liability that has increased or decreased is recognised in the GPWARs; and
- c) the change in the water asset or water liability has an attribute that can be quantified with representational faithfulness; and
- d) the attribute that can be quantified with representational faithfulness is the appropriate unit of account for the particular statement.

Concepts of the Quantification of Attributes of Elements of General Purpose Water Accounting Reports

An element that is recognised in a GPWARs shall be quantified within that GPWARs. Quantification is the process of determining the amount at which an attribute of an element of a GPWARs is recognised in a particular statement within the report.

Quantification of an attribute of an element shall involve:

- a) Selecting the appropriate attribute of an element; and
- b) Selecting the appropriate unit of account; and
- c) Selecting the appropriate quantification approach; and
- d) Using the unit of account and quantification approach to determine the amount of the attribute of the element.

The quantification of an attribute of an element recognised in a GPWARs shall apply the combination of attribute, unit of account and quantification approach that best enables the report to faithfully represent information that is useful for making and evaluating resource allocation decisions.

Concept of Compliance Disclosures in General Purpose Water Accounting Reports

GPWARs shall disclose information that assists users to assess compliance with relevant externally-imposed requirements or with broader notions of best practice relevant to water reporting entities.

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Concepts of the Assurance Of General Purpose Water Accounting Reports

GPWARs shall contain an independent attestation that they reports have been prepared in accordance with approved water accounting standards and other approved pronouncements governing the content of the reports and are consistent with the concepts in the Water Accounting Conceptual Framework.

The attestation of GPWARs shall be conducted in accordance with applicable auditing and assurance standards and ethical standards and principles related to integrity, objectivity, professional competence and due care, confidentiality and professionalism.

Exposure Draft for Water Accounting

Pronouncement

Exposure Draft of Australian Water Accounting Standard 1: Preparation and Presentation of General Purpose Water Accounting Reports.

Summary:

The Exposure Draft of Australian Water Accounting Standard 1 (ED AWAS 1) is published by the Water Accounting Standards Board (WASB) for comment.

Reasons for publishing this exposure draft

One of the objectives of the National Water Initiative (NWI) is to standardise the practice of water accounting in Australia so that consistent and comparable information about water resources is available for decision-makers at:

- a) the national level for policy development;
- b) the jurisdictional level for water resource planning and monitoring;
- c) the water organisation level for water resource management;
- d) the site level for on-site water management; and
- e) the individual level for making decisions about the allocation of resources.

Main features of the exposure draft

The ED AWAS 1 prescribes the basis for preparing and presenting a general purpose water accounting report, which comprises the following components:

- a) a Contextual Statement;
- b) an Accountability Statement;
- c) a Statement of Water Assets and Water Liabilities;
- d) a Statement of Changes in Water Assets and Water Liabilities;
- e) a Statement of Physical Water Flows;
- f) note disclosures; and
- g) an Assurance Statement.

The ED AWAS 1 was developed based on the concepts in the WACF and sets out the following:

- a) the definitions of the water accounting elements (water assets, water liabilities, changes in water assets, changes in water liabilities and net water assets);
- b) the recognition criteria for those elements;
- c) the quantification attribute and unit of account for those elements; and
- d) disclosure requirements.

Included as an appendix to the ED AWAS 1 is a list of defined terms, implementation guidance and a basis for conclusions, which outlines the discussion and assumptions that informed the decisions WASB made while writing the ED AWAS 1.

A group of four model reports have also been prepared in accordance with the ED AWAS 1 as illustrative examples of four different water entities. They are intended to illustrate the application of the ED AWAS 1 in varying situations. The model reports are not static documents and will require regular updating as

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changes arise from new or amended AWAS.

Overview of Proposals of ED AWAS 1

That the following be applied in preparing and presenting a general purpose water accounting report for a water report entity.

The proposed definition of a **water report entity** is:

A water entity in respect of which it is reasonable to expect the existence of users who depend on general purpose water accounting reports for information about water, or rights or other claims to water, which will be useful to them for making and evaluating decisions about the allocation of resources.

The proposed definition of a **water entity** is:

A physical entity, an organisation or individual, that:

- a) holds or transfers water;
- b) holds or transfers rights or other direct or indirect claims to water;
- c) has inflows and/or outflows of water; or
- d) has responsibilities relating to the management of water.

The proposed definition of a **general purpose water accounting report** is:

A water accounting report intended to meet the information needs common to users who are unable to command the preparation of water accounting reports tailored to satisfy their information needs.

Objective of general purpose water accounting reports

The objective of a general purpose water accounting report is to provide information to users of that report that will be useful in:

- a) making and evaluating decisions about the allocation of resources; and
- b) understanding and evaluating the accountability of managers, management groups or governing bodies of the water report entity for the water assets and water liabilities of the water report entity.

Accrual basis of water accounting

The ED AWAS 1 proposes that with the exception of physical water flow information, general purpose water accounting reports are to be prepared using the accrual basis of water accounting.

Contextual Statement

The ED AWAS 1 proposes that a general purpose water accounting report includes a Contextual Statement that provides information that enables users to understand the physical and administrative aspects of the water report entity, and also provides information about the water assets and water liabilities of the water report entity, including any conditions that have had an impact on the management of those water assets and water liabilities.

Accountability Statement

The ED AWAS 1 proposes that a general purpose water accounting report includes an Accountability Statement, and sets out the information to be included in that Accountability Statement. The objective of the information is to assist users to assess whether:

- a) the general purpose water accounting report has been prepared and presented in accordance with Australian Water Accounting Standards;
- b) externally imposed requirements relevant to managing the water assets and water liabilities have been complied with; and
- c) best practices for managing water assets and water liabilities have been applied.

The ED AWAS 1 also proposes specific sign-off requirements for the Accountability Statement and additional disclosure requirements when there has been non-compliance with AWAS or externally-imposed requirements for managing the water assets and water liabilities of the water report entity

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Statement of Water Assets and Water Liabilities:

The Statement of Water Assets and Water Liabilities should provide information that enables users to understand the nature and volumes of water assets and water liabilities of a water report entity. There are three line items to be presented in the Statement of Water Assets and Water Liabilities, and also proposes to require additional sub-classifications of these line items when the volume, nature or function of a subclassified item is such that its separate presentation is relevant to an understanding of the water report entity's water assets and water liabilities.

The ED AWAS 1 proposes to define a **water asset** as:

Water, or the rights or other claims to water, which the water report entity either holds, or for which the water report entity has management responsibilities, and from which an individual or organisation that is a water report entity, or a group of stakeholders of a physical water report entity, derives future benefits.

The ED AWAS 1:65 proposes criteria for determining when an item that meets the definition of a water asset should be recognised in the Statement of Water Assets and Water Liabilities.

In particular, it proposes that a **water asset should be recognised** only when:

- a) it is probable that future benefits associated with the item will be derived by the individual or organisation that is a water report entity or by a group of stakeholders of a physical water report entity; and
- b) the item's volume can be quantified with representational faithfulness.

The ED AWAS proposes guidance on the notion of future benefits, and the on the types of items expected to meet the definition of, and recognition criteria for, a water asset.

Present versus future water rights

The ED AWAS 1 proposes that:

- the definition of a water asset includes rights or other claims to water, and goes on to draw a distinction between present water rights and future water rights,
- to be capable of meeting the definition of a water asset, a right or other claim to water must represent a present right or other present claim to water,
- a future water right is not, at the reporting date, a present right or other present claim to water of the water report entity and is therefore not recognised as a water asset in the Statement of Water Assets and Water Liabilities,
- disclosure requirements for future water rights expected to be realised within 12 months of the reporting date.

Statement of Changes in Water Assets and Water Liabilities:

Information to be presented

The ED AWAS 1 proposes that the Statement of Changes in Water Assets and Water Liabilities:

- provide information that enables users to understand changes in the volumes and nature of a water report entity's net water assets during the reporting period. It proposes five line items to be presented in the Statement of Changes in Water Assets and Water Liabilities, and
- also proposes to require additional sub-classifications of these line items when the volume, nature or function of a sub-classified item is such that its separate presentation is relevant to understanding changes in the water report entity's net water assets.

Statement of Physical Water Flows:

The ED AWAS 1 proposes that the Statement of Physical Water Flows provide information that enables users to understand the nature and volumes of physical water flows experienced by the water report entity during the reporting period. It proposes five line items to be presented in the Statement of Physical Water Flows, and also proposes to require additional subclassifications of these line items when

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the volume, nature or function of a sub-classified item is such that its separate presentation is relevant to understanding the physical water flows experienced by the water report entity.

Group water accounting reports

The ED AWAS 1 proposes:

- to define a group water report entity as: A water report entity comprising individual water entities and for which a group water accounting report is required to be prepared under regulation, statute or directive,
- to define a group water accounting report as: The water accounting report of a group water report entity presented as a single water entity,
- procedures for preparing group water accounting reports.

Note disclosures:

Information about quantification approaches

The ED AWAS 1 proposes:

- specific disclosure requirements about the approaches used to quantify items presented in the water accounting statements,
- Water for environmental, social and cultural, and economic benefit,
- specific disclosure requirements about how the water report entity's,
- water assets have been used during the reporting period in the pursuit of:
 - environmental benefit,
 - social and cultural benefit, and
 - economic benefit,
- that events after the reporting date should be classified as either an 'adjusting event after the reporting period' or a 'non-adjusting event after the reporting period'.

The proposed definition of **an adjusting event after the reporting period** is:

An event that occurs between the end of the reporting period and the date when the Accountability Statement is signed that provides evidence of conditions that existed at the end of the reporting period.

The proposed definition of **a non-adjusting event after the reporting period** is:

An event that occurs between the end of the reporting period and the date when the Accountability Statement is signed that is indicative of conditions that arose after end of the reporting period.

The ED AWAS 1 proposes that volumes recognised in the water accounting statements:

- a) shall be adjusted to reflect adjusting events after the end of the reporting period; and
- b) shall not be adjusted to reflect non-adjusting events after the end of the reporting period.
- c) provides examples of items that represent adjusting and non-adjusting events after the end of the reporting period.

Implementation guidance

The ED AWAS 1 is accompanied by implementation guidance to assist practitioners with some of the more difficult aspects of the ED AWAS 1 to assist in the consistency and comparability of general purpose water accounting reports.

Model reports

The WASB has developed model water accounting reports to illustrate the application of the ED AWAS 1 for four fictitious water report entities that represent four different types of water entities, including:

- a) a water supply system;
- b) a major user of water;
- c) an urban utility supply system; and
- d) an environmental water rights holder.

Proposed Changes and Improvements to Standards

Accordingly, the model reports demonstrate different types of water assets, water liabilities and note disclosures.

Leases

Pronouncement:

[AASB 117 Leases](#)

Summary:

The IASB and FASB announced their intention to re-expose their revised proposals for a common leasing standard. Re-exposing the revised proposals will provide interested parties with an opportunity to comment on revisions the boards have undertaken since the publication of an exposure draft on leasing in August 2010. Even though the boards have not completed all of their deliberations, the decisions taken to date were sufficiently different from those published in the exposure draft to warrant re-exposure of the revised proposals. The boards intend to complete their deliberations, including consideration of the comment period, during Q3 2011 with a view to publishing a revised exposure draft shortly afterwards.

Commenting on the decision, Hans Hoogervorst, Chairman of the IASB said "Although we have yet to conclude our deliberations on this project, the direction of travel indicates that there are aspects of our revised proposals that would benefit from additional input from interested parties." Leslie F Seidman, Chairman of the FASB, said "During our discussions of the extensive comments we received on the exposure draft, the boards have reaffirmed the major change to lease accounting, which is to report lease obligations and the related right-to-use on the balance sheet. However, the boards decided to make many other changes to address the comments made by stakeholders. The boards decided that, while we still have other matters to discuss, stakeholders would appreciate the opportunity to comment on the revised package of conclusions.

Revenue Recognition

Pronouncements:

[AASB 118 Revenue](#)

Summary:

The IASB and FASB issued for public comment a revised draft standard to improve and converge the financial reporting requirements of IFRSs and US GAAP for revenue (and some related costs) from contracts with customers. The proposed standard would improve the reporting of revenue by: providing a more robust framework for addressing revenue recognition issues; removing inconsistencies from existing requirements; improving comparability across companies, industries and capital markets; providing more useful information to users of financial statements through improved disclosure requirements; and simplifying the preparation of financial statements by streamlining the volume of accounting guidance.

If this revised draft standard is adopted, it would replace IAS 18 'Revenue', IAS 11 'Construction Contracts' and related Interpretations. The core principle of the revised proposed standard is the same as that of the 2010 exposure draft, that an entity would recognise revenue from contracts with customers when it transfers promised goods or services to the customer. The amount of revenue recognised would be the amount of consideration promised by the customer in exchange for the transferred goods or services. The boards further refined their original proposals:

- added guidance on how to determine when a good or service is transferred over time
- simplified the proposals on warranties
- simplified how an entity would determine a transaction price (including collectability, time value of money, and variable consideration)
- modified the scope of the onerous test to apply to long-term services only

Proposed Changes and Improvements to Standards

- added a practical expedient that permits an entity to recognise as an expense costs of obtaining a contract (if one year or less).

Accounting and reporting for Grantors in Service Concession Arrangement

Pronouncement

The International Public Sector Accounting Standards Board (IPSASB) has approved IPSAS 32 'Services Concession Arrangements: Grantors'.

Summary:

Service concession arrangements provide a way for governments and other public sector entities to build the infrastructure necessary to maintain and improve critical public services. The use of service concession arrangements continues to increase due to the ongoing global financial and economic crises. Until now, public sector entities have had no international guidance on how to report such transactions.

IPSAS 32 addresses the grantor's accounting in such arrangements using an approach that is consistent with that used for the operator's accounting in Interpretation (IFRIC) 12 'Service Concession Arrangements' issued by the IFRIC of the IASB. IPSAS 32 uses the principles in IFRIC 12 for determining which entity, the grantor or the operator, should recognise an asset in a service concession arrangement, to ensure that the grantor recognises a service concession asset it controls. IPSAS 32 applies to annual financial statements covering periods beginning on or after 1 January 2014, but may be applied earlier.

IPSASB Chair Andreas Bergmann explained, "IPSAS 32 helps further the IPSASB's goal of enhancing the transparency and accountability of public sector entities by ensuring that service concession arrangement assets and their related financing are reported." "It also improves consistency in how public sector entities account for and report service concession arrangements, which are significant and often complex transactions", he added. Hans Hoogervorst, IASB Chair said, "It closes the gap on significant assets not being recognised by either the grantor or the operator, and is a welcome addition to the body of accounting guidance for the public sector."

Carbon Tax

Pronouncement:

Financial Reporting Implications of a Carbon Tax:

Summary:

The AASB has conducted a preliminary discussion of possible accounting implications of a future carbon price mechanism and noted that different views may exist about the accounting treatment under existing Standards of transactions and other events associated with a future carbon tax during its fixed price phase. Formed the tentative view that permits (carbon units) purchased or received free by an emitter are in the nature of assets. Directed staff to prepare an issues paper discussing the various accounting issues involved for both the emitter and the government during the fixed price phase.

Sustainable Public Sector Finances

Pronouncements:

Long-Term Sustainability of a Public Sector Entity's Finances – Proposed Guidance

Summary:

The International Public Sector Accounting Standards Board (IPSASB) has published Exposure Draft 46 'Recommended Practice Guideline – Reporting on the Long-Term Sustainability of a Public Sector Entity's Finances'. ED 46 provides good practice guidelines on reporting on the long-term fiscal sustainability of a public sector entity, and particularly emphasises that entities may be able to draw on projections that are already being made by other bodies, thereby ensuring a cost-effective approach.

The sovereign debt crisis has emphasised the significance of the fiscal condition of governments and other public sector entities to the global economy. There have been heightened concerns about the

Proposed Changes and Improvements to Standards

ability of governments to meet debt servicing obligations and the extent to which they can maintain current policies and meet current and future obligations related to entitlement programs, without raising taxes and contributions or increasing debt to unsustainable levels.

These concerns have reinforced the importance of providing projections of inflows and outflows of resources over the longer term, together with narrative explanations of the main risks facing governments and other public sector entities. This information allows the users of general purpose financial reports to assess the extent to which current policies are sustainable, and complements the financial statements, which remain at the core of public sector financial reporting.

Andreas Bergmann, chair of the IPSASB believes that “the continuing volatility in the world’s financial markets has reinforced the IPSASB’s conviction that financial statements alone cannot provide all the information necessary to enable citizens, investors, and other users to evaluate the long-term fiscal sustainability of governments and public sector entities.” “ED 46 aims to provide straightforward guidance to entities to ensure that information on their fiscal sustainability is complete, relevant, and understandable. I encourage our constituents to give this ED full consideration, provide feedback, and assess the need to report on the long-term sustainability of their finances.”

AASB’s Work Program across Not-for Profits

Commentary;

[AASB’s Work Program Complements Work of the ACNC](#)

Summary:

The Australian Charities and Not-for-profits Commission Implementation Taskforce recently issued a Discussion Paper on the key aspects of the Australian Charities and Not-for-profits Commission (ACNC), including the new reporting framework that it will administer. The AASB is investigating ways to improve, from a cost/benefit perspective, the quality of general purpose financial reports prepared by charities and other not-for-profit (NFP) entities, which should complement the work of the ACNC. Mr Kevin Stevenson, Chairman of the AASB, said “The AASB is actively working on various projects directly relevant to the NFP sector and will consult closely with the ACNC and the NFP sector.”

The NFP related projects the AASB currently has on its agenda are:

Accounting for Income of NFP Entities:

The AASB is reviewing the current requirements by assessing an approach whereby income is not recognised as being earned until performance obligations are fulfilled. Under this approach, in some instances, the income would be recognised later than under current requirements. The AASB expects to issue an Exposure Draft of this approach in 2012

Control in the NFP Sector:

This project seeks to address issues relating to control in the NFP sector, in particular, which entities a NFP entity should consolidate in its financial statements. The AASB expects to issue an Exposure Draft on its proposals in the first half of 2012

Disclosures by NFP Entities:

The AASB recently introduced a second, significantly less onerous, Tier of general purpose financial reporting requirements (RDR), retaining the full recognition and measurement requirements of Australian Accounting Standards, but substantially reducing disclosure requirements. This second Tier of reporting is available to NFP entities (and certain for-profit entities) immediately, subject to the requirements that might be imposed by other regulators. In addition to this second Tier initiative, the AASB plans to further examine opportunities for reducing the disclosure burden on NFP entities, and

Service Performance Reporting:

The AASB is considering the information needs of users of NFP financial reports and has identified

Proposed Changes and Improvements to Standards

information about service performance as an area needing focus. In particular, the AASB is considering issues related to the reporting of inputs, outputs, outcomes and performance measures; it is not just looking at financial information. The AASB is considering what role it should play in perhaps specifying mandatory or non-mandatory non-financial disclosures that would provide input for decision makers.

Reporting Service Performance

Pronouncement:

[Reporting Service Performance Information IPSASB Consultation Paper](#)

Summary:

The IPSASB released a Consultation Paper 'Reporting Service Performance'. The IPSASB considers that reporting service performance information is necessary to meet the objectives of financial reporting, which are to provide information that is useful to users of General Purpose Financial Reports for accountability and decision making. This project aims to present a principles-based approach to developing a consistent framework for public sector entities. The Consultation Paper is open for public comment until 15 March.

Various public sector entities around the world currently report service performance information. In practice, such reporting is diverse. The objective of the IPSASB's service performance information project has been to improve the consistency and comparability of such information across jurisdictions and between entities. Overall, the Consultation Paper proposes a framework for reporting service performance information. The framework includes information on the scope of the service performance information reported, the public sector entity's objectives, the achievement of those objectives, and a narrative discussion of the achievement of all the objectives. The Consultation Paper also proposes a standardised service performance information terminology and working definitions to enhance users' understanding of service performance information reported as outlined in the proposed framework.

IPSASB Chair Andreas Bergmann stressed "Service performance information is essential for accountability for the efficient and effective use of resources, service provision, and achievement public sector entities' objectives. Service performance reporting can provide financial and non-financial, as well as quantitative and qualitative, information about the achievement of service delivery objectives in the current reporting period, as well as anticipated future service delivery activities and resource needs."

The AASB decided to make a submission to the IPSASB on its Consultation Paper (CP) *Reporting Service Performance Information*. As the AASB's Service Performance Reporting project is proceeding under the working assumption that a principles-based Standard on the topic might be developed, the Board decided its submission should reflect that approach, whilst acknowledging that the IPSASB might have a less ambitious objective.

On that basis, the Board decided its submission should recommend the IPSASB considers:

- (a) establishing principles that should be applied in determining what service performance information should be reported in general purpose financial reports to meet the needs of users, instead of providing a list of service performance information that could be reported;
- (b) explicitly defining service performance reporting and the scope of service performance information that belongs in general purpose financial reporting;
- (c) broadening the focus of reporting service performance information to include information about the capacity to provide goods and services and the change in that capacity during the reporting period; and
- (d) clarifying the ambiguity in some of the working definitions and examples in the Consultation Paper.



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This information is provided as a complimentary service to owners of the Australian Infrastructure Financial Management Guidelines by GAAP Consulting. GAAP is an acronym for Generally Accepted Accounting Principles; the Australian equivalent to International Financial Reporting Standards (IFRS).

Note: The Tables below do not cover all developments in Auditing Standards, Ethical Standards and other Public Sector Guidelines issued in the half year ending 31 December 2011.

GAAP Consulting helps entities manage their financial reporting and auditing risks by providing leading edge solutions for professional advice and training services on Generally Accepted Accounting Principles. GAAP Consulting may be contacted at www.gaap.com.au.

Recently Issued AUASB Standards, Ethical Standards and Public Sector guidance

The following authoritative pronouncements have been issued during the year ending 31 December 2011. Each of these pronouncements covers important principles and practice with relevance to those associated with a range of responsibilities across the public sector

Consultation Paper

The Auditing and Assurance Standards Board (AUASB) issued a Consultation Paper entitled 'Assurance Engagements on General Purpose Water Accounting Reports'

Exposure Drafts

The Australian Professional and Ethical Standards Board (APESB) issued an Exposure Draft entitled 'Proposed Changes to Ethical Standards: Valuation Services Standard'

Better Practice Guide

The Australian National Audit Office (ANAO) issued a Better Practice Guide entitled 'Public Sector Audit Committee Better Practice Guide'

Each of these requirements is briefly explained in this Update.

New/Amended Auditing Standards

Assurance Engagements

Pronouncement:

[Assurance Engagements on General Purpose Water Accounting Reports](#)

Summary:

The AUASB and the Water Accounting Standards Board (**WASB**) issued a joint 'Consultation Paper: Assurance Engagement for General Purpose Water Accounting Reports' seeking input from stakeholders on issues related to the development of a standard for assurance engagements on general purpose water accounting reports (**GPWAR**). Feedback on this Paper will be used to develop an exposure draft of an assurance standard which will be released for further public comment. A final standard is anticipated to be available by the end of calendar year 2012.

The Council of Australian Governments (**COAG**) established an intergovernmental agreement on the National Water Initiative. COAG identified the need for consistent water resource accounting that could be standardised, compared, reconciled and aggregated. The 'Commonwealth Water Act 2007' reaffirmed the national importance of water information and identified new functions for the Bureau of Meteorology in water accounting, including issuing National Water Information Standards. The WASB was established in April 2009 as an independent advisory board to the Bureau of Meteorology to oversee and coordinate water accounting standards development.

The WASB issued the 'Water Accounting Conceptual Framework for the Preparation and Presentation of General Purpose Water Accounting Reports' (WACF) and an exposure draft of Australian Water Accounting Standard 1 'Preparation and Presentation of General Purpose Water Accounting Reports' (ED AWAS 1). The WACF requires that GPWAR must be audited or reviewed, but does not establish the framework for assurance engagements on GPWAR. Accordingly, the AUASB and the WASB agreed to work together to develop an assurance standard for such engagements.

Valuation Services Standards

Pronouncement:

[Proposed Changes to Ethical Standards: Valuation Services Standard](#)

Summary:

The Accounting Professional and Ethical Standards Board (APESB) is seeking feedback from stakeholders on an exposure draft in respect of proposed revisions to the existing APES 225 'Valuation Services'. The draft proposes changes, which provide additional guidance in respect of the three types of valuation services engagements and, particularly, the difference between a full scope valuation and a limited scope valuation engagement.

The proposal will also see the introduction of new professional obligations in respect engagement terms, which will require members to disclose:

- definitions of the three different types of valuation services engagements and the identification of the type of valuation service engagement the Member is performing
- the relevant limitations of the valuation service engagement, and
- compliance with APES 225 'Valuation Services'.

Also a schematic diagram and new examples have been developed to depict the difference between different types of valuation service engagements and the demarcation between different types of engagements.

APESB Chair Kate Spargo says there are a number of factors professional accountants will need to consider. "Members will need to determine whether their valuation is full or limited scope, and be able to substantiate this on an objective basis. The new requirements will also necessitate amendments to engagement letters and reporting obligations," she says. "The proposed changes will provide further

New/Amended Auditing Standards

clarity to valuation practitioners and improve the engagement management process,” Ms Spargo concluded.

ANAO Audit Committee Practice Guide

Pronouncement:

[Public Sector Audit Committee Better Practice Guide](#)

Summary:

Audit Committees have an important role in the governance framework of entities by providing an independent source of assurance and advice to Chief Executives/Boards. A distinguishing feature of an Audit Committee within an entity’s governance framework is its independence and objectivity, as Audit Committees do not undertake management responsibilities and are not a substitute for entity management controls and accountabilities.

The aim of the ‘Public Sector Audit Committee Better Practice Guide’ issued by the Australian National Audit Office (ANAO) is to provide guidance on the operation of the Audit Committees of public sector entities operating under both the Financial Management and Accountability Act 1997 and the Commonwealth Authorities and Companies Act 1997. The Guide updates and replaces the ANAO’s 2005 ‘Public Sector Audit Committees Better Practice Guide’.

The Guide is intended as a reference document for Chief Executives, Boards, members of Audit Committees and senior managers with responsibility for Audit Committee activities, and complements the ANAO’s Better Practice Guide ‘Public Sector Internal Audit’ issued in September 2007. The ANAO has also supplied a number of checklists and templates which supplement this better practice guide.

The key messages are that a better practice audit committee is distinguished by the following attributes:

- Has a clearly documented charter that has been determined having regard to relevant legislative requirements and the entity’s broader corporate governance framework and is approved by the Chief Executive/Board,
- Possesses broad business, financial management and public sector experience and expertise,
- Has a sound working relationship with the Chief Executive/Board,
- Is able to exercise discretion in determining how best to meet its responsibilities,
- Adopts an independent perspective and appreciates the separation of management and Audit Committee responsibilities,
- Is knowledgeable about the entity’s operations, particularly the entity’s risks and the arrangements in place for the management of these risks,
- Is chaired by a person who is able to lead discussions, encourage the participation of other members, and conduct meetings in an effective manner,
- Encourages and maintains an open and constructive dialogue with senior management, internal and external audit, and other committees.



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Consumption of Future Economic Benefits

Future economic benefits (FEB) for infrastructure are the entity's ability to provide services to its customers/ community in the future.

Methodology for determining consumption of FEB is:

1. Define the services.
2. Identify measures of consumption of services
3. Identify patterns of consumption.
4. Select the depreciation method.

Three examples of the methodology are shown below for:

- Stormwater drainage pipeline asset,
- Local street pavement asset,
- Arterial road pavement asset.

Consumption of FEB - Drainage Example



FEB = conveyance of stormwater from roadways and private land

Measures of consumption of FEB

1. Volume of stormwater conveyed.
2. Time that drain is available to convey stormwater.

Determining pattern of consumption of FEB

- No available on stormwater volumes conveyed
- Consumption is assumed to be constant for each year
- Best available measure of consumption is time.

Select depreciation method

- Use straight line depreciation method (consumption is constant over the useful life).

Consumption of FEB – Local Street Example



FEB = conveyance of people, goods and services by vehicular traffic

Measures of consumption of FEB

1. Annual average daily traffic records.
2. Time that street is available for vehicular traffic

Determining pattern of consumption of FEB

- 1% growth pa in AADT over past 10 yrs

Factors affecting future consumption

- Development – street is fully developed
- Vehicle ownership rates – likely to remain constant
- Vehicle operating costs – likely shift to other transport modes (bicycles and walking)
- AADT estimated to be constant in future

Select depreciation method

- Use straight line depreciation method (consumption is constant over the useful life).

Consumption of FEB – Arterial Road Example



FEB = conveyance of people, goods and services by vehicular traffic

Measures of consumption of FEB

1. Annual average daily traffic records.
2. Time that street is available for vehicular traffic

Determining pattern of consumption of FEB

- 4% growth pa in AADT over past 10 yrs

Factors affecting future consumption

- Development – road serves developing areas
- AADT estimated to increase at 4% per year for foreseeable period

Select depreciation method

- Use output/service consumption method with 4% annual growth rate.

Application of the depreciation method selected for the arterial road example can be demonstrated by the following example.

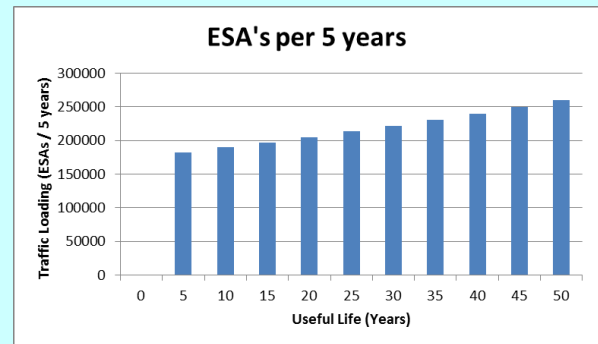
Arterial Road Example

- Design traffic - 100 ESA's per day
- Design life – 50 years
- Traffic increase 4% per years
- Design pavement traffic load 2.2M ESAs

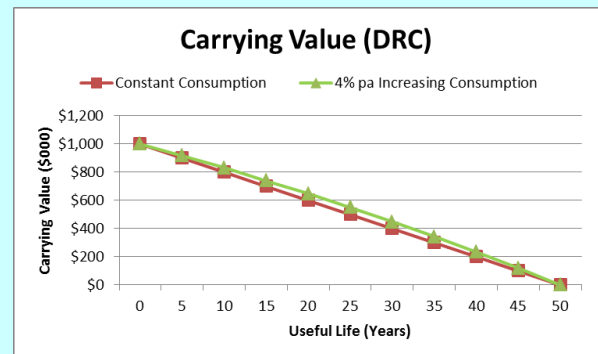
Projected Carrying Value (DRC) and Depreciation – Arterial Road Example

Arterial Roads Design

- Design traffic - 100 ESA's per day
- Design life – 50 years
- Traffic increase 4% per years
- Design pavement traffic load 2.2M ESAs



Projected Carrying Value (DRC)



Projected Depreciation

