IV FINANCIAL ASSET AND LIABILITY FRAMEWORK

Re-Issued: 16 June 2016

1 INTRODUCTION

Application and Operative Date

This Accounting Policy Framework is re-issued on the 16 June 2016 and applies to the general purpose financial statements of each public authority for the reporting period ending on or after 30 June 2016. It replaces the APF IV issued in March 2016 which is hereby revoked.

Scope

The purpose of this Accounting Policy Framework is to address the issue of identification, recognition and measurement of financial assets and liabilities with specific reference to employee benefits. It allows a short-hand method to be used to calculate long-service leave obligations. With respect to financial assets and liabilities, it requires public authorities that are not public financial corporations or insurers to value financial instruments, other than derivatives, at cost.

Australian Accounting Standards

The following Australian Accounting Standards have general application in relation to the accounting for financial assets and liabilities.

AASB 7 *Financial Instruments: Disclosure* requires disclosure to enable users to evaluate the significance of financial instruments on an entity's financial position and performance. Other disclosure requirements include the nature and extent of risks arising from financial instruments, and how the entity manages those risks. The principles in this Standard complement the principles for recognising, measuring and presenting financial assets and financial liabilities in AASB 132 *Financial Instruments: Presentation* and AASB 139 *Financial Instruments: Recognition and Measurement*.

AASB 119 *Employee Benefits* prescribes the accounting treatment and reporting requirements for employee benefits including post-employment benefits.

AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* prescribes the accounting and disclosure of provisions, contingent assets and contingent liabilities.

AASB 132 *Financial Instruments: Presentation* establishes principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset.

AASB 139 *Financial Instruments: Recognition and Measurement* prescribes the principles for recognising and measuring financial assets, financial liabilities, and some contracts to buy or sell non-financial items. Some of this standard's requirements include recognising financial assets and liabilities in the Statement of Financial Position and for measurement purposes, classification of financial instruments into one of four categories.

2 MEASUREMENT OF FINANCIAL ASSETS

APS 2.1 Other than as specifically required or exempted in this APF and APF III *Asset Accounting Framework* APS 13.2 and APS 13.4, all government reporting entities will use the historical cost measurement for debt and financial assets and the fair value measurement basis for derivatives.

APS 2.2 The following entities are exempt from the requirements of APS 2.1:

- Public financial corporations eg HomeStart, SAFA;
- Public insurers eg SAICORP, MAC; and
- Public Trustee and Universities.

3 LIABILITIES AND COMMITMENTS

What are liabilities?

3.1 A liability is 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.

3.2 The key features are that there must be:

- a present obligation to an external party;
- the obligation must have arisen from a past event; and
- there must be an outflow of future economic benefits.

3.3 Indicators of a present obligation would include:

- a firm agreement;
- the probability that either party to the agreement would suffer loss from cancellation by the other party; and
- the probability that the other party would succeed in any action to secure performance or significant compensation.

3.4 Indicators of past event:

- the specification of a past event differentiates liabilities from intentions to sacrifice economic benefits in the future (which are not to be recognised).
- a transaction or event giving rise to the present obligation to sacrifice future economic benefits must have occurred.

3.5 Indicators of future economic benefits:

Outflows of future economic benefits can take various forms such as the payment of cash, transfer of assets, provision of services, replacement of an obligation with another obligation or the conversion of the obligation to equity.

When to recognise liabilities

3.6 A liability should be recognised in the Statement of Financial Position when and only when:

- it is probable that the future sacrifice of economic benefits will be required; and
- the amount of the liability can be measured reliably.

3.7 The term probable means that the chance of the future sacrifice of economic benefits being required is more likely rather than less likely.

Items that Fail the Recognition Criteria

3.8 Liabilities that do not meet the recognition criteria will be disclosed in the explanatory notes and will not be reported in the Statement of Financial Position.

Distinguishing between Liabilities and Commitments

3.9 Commitments represent an intention to sacrifice future economic benefits. They are different from liabilities in that they lack the element of a present obligation.

3.9.1 Commitments and liabilities arise at separate points on the time-line in the process of incurring a liability. Merely establishing a grant program or making the decision to purchase or undertake a venture would not give rise to a present obligation.

3.9.2 The point at which a commitment becomes a liability is generally when the intention to sacrifice future resources becomes a present obligation.

This would normally occur when:

a) there is firm agreement;

b) it is probable that either party to the agreement would suffer substantial loss from cancellation by the other party; and

c) it is probable that the other party would succeed in any action to secure performance or significant compensation.

3.10 The tables below illustrate the timeline of events during which a commitment becomes a liability:

Payment of an unconditional grant

Stage	Application received	Decision / offer made to applicant	Enforceable agreement	Payment made
Classification		Commitment	Record expense and liability and remove commitment	Remove liability

Payment of a conditional grant in advance

Stage	Application received	Decision / offer made to applicant	Enforceable agreement	Payment made	Confirmation that conditions have been met
Classification		Commitment	Commitment	Record a prepaid expense (asset)	Reduce prepayment and recognise expense

APS 3.11 Where material, details of commitments (other than commitments for the payment of salaries and wages to employees) must be disclosed in the explanatory notes. Commitments are to be disclosed in the time bands as follows:

- Not later than one year
- Later than one year but not later than five years
- Later than five years

4 CONTINGENT LIABILITIES AND PROVISIONS

Contingent Liabilities

4.1 Contingent liabilities are:

a. possible obligations that arise from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

b. present obligations that arise from past events but are not recognised because:

   i. it is not probable that an outflow of resources will be required to settle the obligation; or

   ii. the amount of the obligation cannot be measured with sufficient reliability.

4.2 Determining contingent liabilities will in some cases be a matter of fact, and in others will involve management judgement which may require reports from independent experts.

Provisions

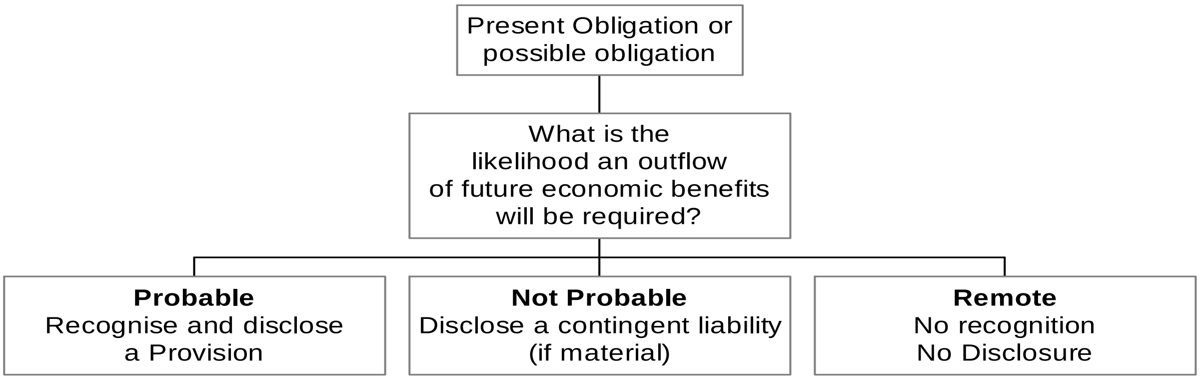
4.3 Provisions are liabilities for which the amount and timing of the future sacrifices of economic benefits that will be made is uncertain e.g. workers compensation.

APS 4.4 Workers compensation will be reported as a provision and not an employee benefit.

4.5 In the context of doubtful debts and depreciation, the term provision refers to an adjustment to the carrying amount of the associated asset (receivables and non-current assets) and is not a liability.

Recognition

4.6 Where as a result of past events, outflows of future economic benefits may be required, the following decision tree identifies the recognition and disclosure requirements:


Present Obligation or possible obligation
What is the likelihood an outflow of future economic benefits will be required?
Probable
Recognise and disclose a Provision
Not Probable
Disclose a contingent liability (if material)
Remote
No recognition
No Disclosure

5 EMPLOYEE BENEFITS

Introduction

5.1 For the purposes of preparing general purpose financial statements, an employee is any person engaged under any Act, Award or other contract of service and who receives a salary or a wage along with other benefits from the government reporting entity.

5.2 The government reporting entity that pays the employee's salary or wage is defined as the employer, and is initially responsible for incurring and reporting all employee benefits.

5.3 Employee benefits should be determined through specific reference to the appropriate legislation, awards or service contracts applicable to the employees of an entity.

Short-term Employee Benefits

5.4 Short-term (ie expected to be settled within 12 months after the end of the reporting period in which the employee rendered the services) employee benefits are to be measured at nominal amounts. This includes salaries and wages, annual leave, skills and experience retention leave and sick leave.

5.5 Most government reporting entities will continue to measure annual leave liability and skills and experience retention leave liability at nominal amounts, due to the immaterial effect of discounting. Refer to 5.7 example nominal amount.

5.6 In using the nominal amount, each government reporting entity should consider whether its experience profile, in relation to its annual leave liability and skills and experience retention leave, is different to that of most other government reporting entities such that the entity would undertake a present value calculation.

For example, sometimes a government reporting entity may have substantial excessive annual leave balances that if measured at nominal amounts would result in a material error to the accounts. In this unusual event, a reporting entity would measure annual leave at its present value. Refer to 5.7 example present value.

5.7 The Department of Treasury and Finance recommends a salary inflation rate of 3.0% per annum be applied to the salary rates current at reporting date to determine the nominal amount (i.e. the amount the entity expects to pay).

For example – nominal amount

The annual leave liability report as at 30 June 201X states the total annual leave liability for the entity is $100 000. (This report has used remuneration rates current as at 30 June 201X.) Hence nominal amount for the annual leave liability is:

$100 000 *1.03 = $103 000

For example – present value

The annual leave liability report as at 30 June 201X states the total annual leave liability for the entity is $500 000. 80% of this balance relates to entitlements that are excessive and it is the entity's expectation that this substantial and excessive entitlement will be settled in 5 years. For the purposes of this example assume a 5 year bond rate of 5.25%.

$500 000*1.03 = $515 000

It is expected that 30 employees (totalling $100 000 of leave liability) entitlement to annual leave will be settled within 12 months. Nominal amount for the annual leave liability is $103 000.

It is expected that 25 employees (totally $400 000 of leave liability) excessive entitlement will be settled within 5 years. Each of these employees' leave balances will be increased by the salary inflation rate of 3% and NPV at 5.25%.

5.8 In applying the salary inflation rate, each government reporting entity should consider whether its experience of salary increases and/or its EB arrangements are sufficiently different to that of most other government reporting entities to render use of the salary inflation rate unreliable in estimating short-term employee benefits. In these circumstances, the entity should undertake its own calculation of the short-term employee benefit liability and would need to show that its calculation complies with the requirements of AASB 119.

With regard to sick leave, benefits may accumulate similar to annual leave benefits but are usually only paid upon a valid claim for sick leave. On average, sick leave taken each reporting period would be equal to or less than the entitlement accruing in that period and therefore no liability needs to be recognised. If past experience indicates otherwise, it would be necessary to recognise that component of accumulated benefits expected to result in payments to employees, measured at nominal amount.

Long-term Employee Benefits

5.9 Long-term (ie not expected to be settled within 12 months after the end of the period in which the employees rendered the service) employee benefits are to be measured at the present value of the future cash outflows. This includes all benefits other than short-term employee benefits, post employment benefits and termination benefits.

APS 5.10 The discount rate to be applied is the prevailing market yield on Commonwealth or State Government bonds of a term similar to the average term of the liability.

5.11 To assist government reporting entities in determining long service leave liability, the Department of Treasury and Finance has developed a long service leave module within the BMS system which contains an actuarial analysis to determine an estimate of the present value of future cash outflows associated with the long service leave liability. The Department of Treasury and Finance recommends a salary inflation rate of 4.0% per annum be applied for long term employee benefits.

Current / Non-current classification of Long Service Leave

5.12 AASB 101 *Presentation of Financial Statements* requires liabilities to be classified as current when the relevant criteria are met. One of the criteria is where the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.

5.13 In relation to long service leave, an unconditional legal entitlement to payment arises after a qualifying period of service (usually ten or fifteen years). Accumulation of long service leave entitlement continues after this point until the leave is taken. This entitlement is termed the "unconditional" entitlement category.

In certain circumstances a legal entitlement to pro rata payment in lieu of long service leave arises. This entitlement is termed the 'conditional' entitlement category.

5.14 To assist entities in calculating the conditional component of the long service leave, a report will be available from the long service leave module within BMS which will provide the percentage of the long service leave that could be considered conditional.

5.15 In using this report, entities should also consider specific legislative provisions, policies and practices in relation to the approval of long service leave.

Post-employment Benefits

5.16 Post-employment benefits are employee benefits (other than termination benefits) which are payable after the completion of employment. In the SA public service this applies to superannuation.

5.17 All SA Government employees are covered by a superannuation scheme operated by the Government, statutory authorities or other public sector organisations. These schemes include member and employer contributions to voluntary schemes and employer contributions to the Southern State Superannuation Scheme, in lieu of Commonwealth mandated Superannuation Guarantee arrangements, for employees who are not members of the voluntary schemes.

5.18 The provision of superannuation gives rise to liabilities for payment of future benefits by employers. The extent of the liability of a superannuation scheme will depend upon the nature of the scheme and the types of benefits it provides.

APS 5.19 For the majority of government controlled reporting entities, the Treasurer assumes the accruing superannuation liability in return for periodic payments calculated by Super SA as either a factor of contribution amounts paid by employees or a percentage of the employees' eligible earnings. Payment, of amounts owing in respect of each pay period, is required within seven days of the end of the entity pay period.

APS 5.20 For those entities discussed at APS 5.21, at reporting date the amount of any employer superannuation contributions due but not yet paid to the Treasurer will constitute a current liability and will be classified in the Statement of Financial Position as a payable. The liability for employees' superannuation entitlements rests with the Treasurer and would not be reported by individual government reporting entities.

5.21 Government reporting entities that sponsor superannuation schemes on behalf of their employees are responsible for measuring and recognising any expenses or liabilities resulting from those schemes. The requirements are covered extensively within AASB 119.

Employment On-costs

5.22 Employment on-costs are recognised as liabilities and expenses where the employee benefits to which they relate have been recognised as liabilities and expenses.

5.23 In determining whether settlement of employee benefit liabilities will give rise to the payment of employment on-costs, an entity should consider whether they are likely to be extinguished through resignation/termination or through the taking of leave.

5.24 The Department of Treasury and Finance has calculated an average percentage for the proportion of long service leave estimated to be taken as leave (and the proportion taken as a lump sum payment) at a whole of government level. Each government reporting entity should consider whether their experience is sufficiently different to render the use of these averages unreliable. The current estimates for the proportion of long service leave taken as leave are:

Education	62%
Health units	51%
Other entities	40%

APS 5.25 Liabilities for employment on-costs will be classified as payables and not employee benefits. The determination of the current and non-current portions of the liabilities will be based on the classification of the employee benefits to which they relate.

5.26 Employer superannuation contributions relating to accrued salaries and wages or annual leave liability will be determined using the same basis for calculation as for each pay period in respect of salaries and wages.

5.27 With regards to long-service leave liabilities, employer superannuation contributions are not incurred in respect of lump sum payments. Therefore a government reporting entity must determine the proportion of long-service leave it expects will be taken as leave and calculate the superannuation contributions relating to that amount to be recognised as an on-cost liability.

5.28 Where the liability for long-service leave is determined based on a group of employees using an actuarial estimate the liability to each employee will not be available and therefore an average factor across schemes will need to be determined. Similarly, the proportion of long service leave estimated to be taken as lump sums cannot readily be determined without recourse to the data forming part of the actuarial calculation. To assist government reporting entities using the LSL module within the BMS system to calculate their long service leave liability, the Department of Treasury and Finance has calculated an average factor for the calculation of the employer superannuation contribution on-cost of 10.2%.

APS 5.29 Where employees transfer between government reporting entities, any liabilities for employee benefits accrued up to the transfer date are usually transferred to the transferee entity. In these circumstances the transferor entity will extinguish any employee benefit liabilities and recognise income equivalent to the liabilities extinguished. The transferee entity will recognise an expense and a liability for the benefits transferred.

APS 5.30 In those circumstances where the transferor entity makes a payment to the transferee entity in consideration for the assumption of the liability for employee benefits of transferring employees, the transferor will extinguish liabilities and recognise a decrease in assets (cash) or an increase in liabilities (cash payable). The transferee will correspondingly recognise the liability assumed and an increase in assets (cash or cash receivable). To the extent that the payment is less than the liability assumed, the transferor will recognise income equal to the amount of the shortfall and the transferee will recognise an expense.

5.31 Agencies should note, the requirements of Determination 3.1 Employment Conditions - Leave in relation to transfers of entitlements between government reporting entities.

5.32 The extent to which employee benefits have not been paid as at the reporting date will represent a liability.

5.33 Employee benefit disclosure requirements are illustrated in the model financial statements issued pursuant to Treasurer's Instruction 19 *Financial Reporting*.

6 MEASUREMENT OF FINANCIAL LIABILITIES

APS 6.1 Other than as specifically required or exempted in this APF and APF III *Asset Accounting Framework* APS 13.2 and APS 13.4, all government reporting entities will use the historical cost measurement for debt and financial assets and the fair value measurement basis for derivatives.

APS 6.2 The following entities are exempt from the requirements of APS 6.1:

- Public financial corporations eg HomeStart, SAFA;
- Public insurers eg SAICORP, MAC; and
- Public Trustee and Universities.

Accounting for Interest Free Loans

APS 6.3 All interest free loans will be recorded at the present value of expected repayments, being expected future cash payments discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate, and other factors) with a similar credit rating at the time of the loan's initiation. The remaining balance (that is, the difference between the amount borrowed and the present value) will be recorded as revenue.

Example: An interest free 10 year loan payable with a single repayment to be made after 10 years. The 10 year bond rate at the date of origination (1 July) is 7% and the calculation of the present value of the repayment is:

	YR 1	YR 2	YR 3	YR 4	YR 5	YR 6	YR 7	YR 8	YR 9	YR 10
Face Value	10 000	10 000	10 000	10 000	10 000	10 000	10 000	10 000	10 000	10 000
Book Value	5 439	5 820	6 227	6 663	7 130	7 629	8 163	8 734	9 346	10 000

Accounting entry for Yr 1

DR	Cash	10 000
CR	Loan Payable	5 439
CR	Revenue	4 561

(recognise loan payable at fair value in accordance with APS 6.3)

Accounting entry for Yr 2

DR	Interest expense	381
CR	Loan payable	381

(record amortisation of loan)

Accounting Entry for Yr 10

DR	Loan Payable	10 000
CR	Cash	10 000

(record the loan repayment)

Materiality Thresholds for Interest Free Loans

6.4 Government reporting entities may control interest free loans that have been provided/ received for a very long period of time that, if they were to be accounted for in accordance with APS 6.3, would result in excessive accounting effort for very limited benefits. These would include, for example, government assistance loans provided for 99 years.

APS 6.5 To minimise the administrative burden, interest free loans provided/received for a very long period of time should have a carrying value of zero.

Discount Rate

APS 6.6 In the absence of a relevant prevailing interest rate (refer APS 6.3), the appropriate discount rate will be equal to the market yield on long-term Commonwealth bonds at the time the loan was provided plus an average risk margin of 2.5%.

6.7 For the purposes of APS 6.3 the discount rate first used (i.e. at the time the loan was initiated) remains the appropriate discount for the remainder of the loan term.