NSW GOVERNMENT | Treasury

Treasury Circular

TC19-06
27 June 2019

Financial Statements Disclosures for Machinery of Government Changes

Machinery of Government (MoG) changes often result in abolition/creation of government entities and movement of functions between entities. Appropriate financial reporting and sufficient disclosures are required from both transferors and transferees to reflect the financial impact of MoG changes. This Circular prescribes the basis of preparing financial statements and disclosure requirements prior to and in the year of MoG changes.

This Circular is issued as a Treasurer's Direction under section 9 and section 45E of the *Public Finance and Audit Act 1983* (the Act) and therefore applies to all entities that are required to prepare general purpose financial statements under the Act. This Policy is also mandatory for Statutory State Owned Corporations. A specific reference to this Circular will be included in the Statements of Corporate Intent of those entities.

Treasury may subsequently limit or vary application of this Direction pursuant to section 9(3) of the Act.

Background

A Machinery of Government (MoG) change occurs when Government decides to change how State responsibilities are managed. MoG changes may result in a combination of:

- abolishing government departments and/or statutory bodies as defined by the Act;
- creating new government departments and/or statutory bodies; and
- moving functions, resources and people between government departments and/or statutory bodies.

MoG changes are treated as restructures of administrative arrangements under AASB 1004 *Contributions*:

> **Restructure of Administrative Arrangements**
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> The reallocation or reorganisation of assets, liabilities, activities and responsibilities amongst the entities that the government controls that occurs as a consequence of a rearrangement in the way in which activities and responsibilities as prescribed under legislation or other authority are allocated between the government's controlled entities.
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> [AASB 1004, Appendix A]

This policy considers the impact of MoG changes on:

(a) the going concern basis of preparation of financial statements; and
(b) financial statements disclosures requirements in the financial year immediately prior to a MoG change and in the year of the MoG change.

This policy uses MoG changes as at 1 July 2019 as examples, but the principles apply to all MoG changes.

Going Concern

The Going Concern Concept

The going concern concept is fundamental to the preparation of financial statements under Australian Accounting Standards.

AASB 101 *Financial Statements Presentation* requires:

> When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.
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> [AASB 101, para 25]

The going concern concept is fundamental to the measurement and presentation of assets and liabilities in the statement of financial position. For instance, assets and liabilities are presented as either 'current' or 'non-current', based in part on the timing of their expected use or settlement. Similarly, under the going concern concept, assets and liabilities are measured on the assumption the entity will continue in operation for the foreseeable future, and not on the basis the entity needs to dispose of those assets and settle liabilities on say, a liquidation basis.

Applying the Going Concern Concept to MoG Changes

Most MoG changes relate to the transfer of ongoing functions and activities to another department and/or statutory body, without a significant reduction or termination of those activities. The department and/or statutory body taking over those activities is expected to use, recover or settle the transferred assets and liabilities in the same manner as the transferee. In other words, in the ordinary course of business.

In these circumstances, the financial statements of departments or statutory bodies that will cease to exist after 30 June 2019 must be prepared on a going concern basis.

Departments and statutory bodies ceasing to exist from 1 July 2019

Management must make an active assessment of the going concern concept with respect to assets and liabilities that will transfer to other departments and/or statutory bodies on 1 July 2019. However, it is expected this assessment will lead to the financial report for the year ended 30 June 2019 being prepared on a going concern basis, because the assets and liabilities will be used, recovered or settled in the normal course of business by the transferee department(s) and/or statutory body(ies).

This means the financial report of a department/statutory body for the financial year prior to its abolition and in the year of the abolition, will be prepared on a going concern basis, using all AAS measurement and presentation requirements. This includes classifying assets and liabilities on the basis that the operations will continue in the foreseeable future, except for the assets and liabilities that meet the 'held for sale' criteria in AASB 5[1].

Going Concern – Disclosures

Where its financial report is prepared on a going concern basis, management need only document their rationale, unless there are material uncertainties. However, departments/statutory bodies that will cease to exist following a MoG change, must disclose in their financial report that the going concern concept has been applied despite the cessation of its activities and management's rationale.

Example Going Concern Disclosure – Accounting Policy Note

Department A will cease to exist after 30 June 2019

The financial statements of Department A have been prepared on a going concern basis. In accordance with Administrative Arrangements (Administrative Changes – Public Service Statutory bodies) Order 2019 the Department A was abolished on 1 July 2019. On abolition, the Department's employees, assets, rights and liabilities were transferred to Department B and will be used, recovered or settled in the normal course of business by the transferee department. (See note *Events after the reporting Period.*)

New Accounting Standards

Requirement to Disclose Impacts of New Standards

AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* requires disclosure of information on the estimated impacts of new Australian Accounting Standards that have been issued but are not yet effective.

When an entity has not applied a new Australian Accounting Standard that has been issued but is not yet effective, the entity shall disclose:
(a) this fact; and

[1] Restructure of administrative arrangements is not in the scope of AASB 5 (AASB 5, para Aus2.1)

> (b) known or reasonably estimable information relevant to assessing the possible impact that application of the new Australian Accounting Standard will have on the entity's financial statements in the period of initial application.
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> [AASB 108, para 30]

There are currently several Australian Accounting Standards that may have a significant impact on financial reports for 2019-20 and 2020-21 financial years. These are:

- AASB 15 *Revenue from Contracts with Customers*,
- AASB 1058 *Income of Not-for-Profit Entities*,
- AASB 16 *Leases*,
- AASB 1059 *Service Concession Arrangements: Grantors*.

Impact of MoG Changes on Disclosures about New Accounting Standards

Departments and statutory bodies that exist before and/or after MoG changes, must disclose information about the impact of the new accounting standards on their continuing operations. However, applying this requirement to statutory bodies impacted by MoG changes is less straightforward. This is because:

- **Departments/statutory bodies that will cease to exist** after MoG changes, will not prepare financial reports for the subsequent periods that are affected by the new Accounting Standards.
- **New departments/statutory bodies created** by MoG changes that happen in the next financial year (e.g. 1 July 2019), will not prepare a financial report for the current financial year.
- **Existing departments/statutory bodies inheriting** functions as a result of MoG changes, need to consider how to disclose the impact on pre-MoG activities and post-MoG activities.
- **Existing departments/statutory bodies transferring** out functions, similarly need to consider how to disclose the impact on pre-MoG activities and post-MoG activities.

Table 1 Disclosures of Impact of New Standards in Financial Year Prior to MoG Changes (30 June 2019)

Situation	Requirement	Rationale
Departments/statutory bodies that will **cease to exist**	Disclose information on the estimated impact of new accounting standards on existing financial report. The disclosure must be consistent with AASB 108.30.	The last financial report pre-MoG change is expected to be prepared on a going concern basis, because activities will continue for the foreseeable future (refer *Applying the Going Concern Concept to MoG Changes* above). For completeness of information from the State's perspective, every reporting entity must comply with the disclosure requirements, although some functions of government entities will be reallocated after year end.
New departments/statutory bodies created	No requirement to prepare financial report for 30 June, where created on 1 July.	Financial report is not required for 30 June 2019.
Existing departments/statutory bodies **inheriting** functions	- Disclose information on the estimated impact of new accounting standards on financial report in respect of existing functions as at 30 June 2019 under AASB 108.30.	Impacts of new accounting standards must be disclosed for existing functions. (Refer section on *Events after reporting date* for disclosure of Impact of new standards on transferred functions).
Existing departments/statutory bodies **transferring** out functions	- Disclose information on the estimated impact of new accounting standards on financial report in respect of existing functions as at 30 June 2019 under AASB 108.30.	Impacts of new accounting standards must be disclosed for existing functions (Refer section on *Events after reporting date* for disclosure of Impact of new standards on transferred functions).

Other Obligations with Respect to New Accounting Standards

Information on the estimated impact of new accounting standards is required for:

1. Departments/statutory bodies inheriting functions.
2. Departments/statutory bodies recognising revenue, that is an administered item of another department/statutory body.

3. Total State Sector Accounts.

> Other requirements for NSW departments/statutory bodies:
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> 1. Complete assessments of the impact of all new accounting standards effective 1 July 2019, on their existing (pre-MoG) functions, including for administered activities.
> 2. Departments/statutory bodies transferring their functions post-MoG, must ensure sufficient information on the new accounting standards is transferred to the statutory body/department inheriting those functions.
> 3. Transferor and transferee departments/statutory bodies must agree procedures to ensure the disclosures in respect of MoG changes (including new accounting standards change and events after the reporting period) are consistent in the respective financial statements.

Events after the Reporting Period

Requirement to Disclose Significant Events after the Reporting Period

AASB 110 *Events after the Reporting Period* requires the adjustment for, or disclosure of, significant events that occur after the balance date.

> Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue. Two types of events can be identified:
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> (a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and
>
> (b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).
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> [AASB 110, para 3]

MoG changes that occur after balance-date are non-adjusting events, because they do not affect the recognition or measurement or revenue, expense, assets or liabilities at balance date. Under AASB 110, entities must disclose information about material non-adjusting events.

> If non-adjusting events after the reporting period are material, non-disclosure could influence the economic decisions that users make on the basis of the financial statements. Accordingly, an entity shall disclose the following for each material category of non-adjusting event after the reporting period:
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> (a) the nature of the event; and
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> (b) an estimate of its financial effect, or a statement that such an estimate cannot be made.
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> [AASB 110, para 21]

Impact of MoG Changes on Events after the Reporting Period Disclosures

Departments and statutory bodies that are impacted by MoG changes that occur after balance date must disclose appropriate information as part of a post-balance date events note in their financial report for the year ending 30 June. These disclosures must include both:

A. The financial impacts of the transfer of existing functions/inheriting of new functions.

AND

B. The estimated impact of new Accounting Standards on new functions (i.e. those functions transferred in/out post-balance date).

As for the impact of new Accounting Standards, the disclosure for events after the reporting period must include all functions transferred in/out post-balance date, including administered activities.

Materiality must be applied in determining the extent and detail of such disclosures. Minimum requirements are presented in ***Table 2 Events after the Reporting Period – Summary of MoG Disclosures*** below.

Table 2 Events after the Reporting Period – Summary of MoG Disclosures

Situation	Disclose
Departments/statutory bodies that will **cease to exist**	Nature of the MoG change, the legal Orders authorising the change and the counterparty transferee department(s)/statutory body(ies). Where the department/statutory body transfers its functions to multiple departments/statutory bodies, summary balance sheets and information about income and expenses in respect of functions transferred to each counterparty. These amounts must incorporate the impacts of new Accounting Standards and make a statement to that effect.
New departments/statutory bodies created	No requirement to prepare financial report for 30 June, where created on 1 July.
Existing Departments/statutory bodies **inheriting** functions	Nature of the MoG change and legal Orders authorising the change. Financial impact of functions inherited post-balance date via MoG changes (e.g. summary of balance sheet and information about income and expenses inherited post-balance date) and the counterparty transferor entity. These amounts must incorporate the impacts of new Accounting Standards, and make a statement to that effect. Where the department/statutory body inherits functions from multiple departments/statutory bodies, separate disclosures must be made for each transfer, if material.

Situation	Disclose
Existing departments/statutory bodies **transferring** out functions	The nature of MoG change and legal Orders authorising the change. Financial impact of functions transferred post-balance date via MoG changes (e.g. summary of balance sheet and information about income and expenses for functions transferred post-balance date) and the counterparty transferee entity. These amounts must incorporate the impacts of new Accounting Standards and make a statement to that effect. Where the department/statutory body transfers its functions to multiple departments/statutory bodies, separate disclosures must be made for each transfer, if material

Providing Information to other Departments/Statutory bodies

NSW departments/statutory bodies transferring functions out are required to provide sufficient information to the transferees in respect of the disclosures required under AASB 110.

Accounting and Disclosures in the Year of the MoG Change

TPP 09-3 *Contributions by owners made to wholly-owned Public Sector Entities*

Statutory bodies also need to consider the accounting and disclosures required in the actual year of the MoG change. e.g. for MoG changes effective 1 July 2019, this means the 2019-20 Financial year. TPP 09-3 *Contributions by owners made to wholly-owned Public Sector Entities* (TPP 09-3) provides policy on the following, for transfers under administrative restructures:

a) Accounting for the transfer of assets and liabilities between departments/statutory bodies;

b) Accounting for revenue and expenses for transferred activities pre and post the transfers; and

c) Disclosures required about transfers.

In particular, TPP 09-3 requires detailed disclosures about transferred activities, to enable comparisons with previous years. Departments/statutory bodies must refer to TPP 09-3 for detailed policy on the required disclosures. However, this section summarises the main requirements. The requirements in TPP 09-3 must be extended to administered activities.

Situation	Disclose
Departments/statutory bodies that will **cease to exist**	No reporting requirements for entities that cease to exist on 1 July. For entities that cease to exist after 1 July: • Statement of Accounting Policy:

Situation	Disclose
	➢ Accounting policy for restructure ➢ Classes of assets and liabilities for each material transfer, including name of counterparty ➢ Adjustments to asset/liability values as a result of the restructure
New departments/statutory bodies created	For each transferred activity: • Income statement, showing separately expenses and revenues recognised by the transferor. • Comparative figures for the previous financial year. • Statement of Accounting Policy: ➢ Accounting policy for restructure ➢ Classes of assets and liabilities for each material transfer, including name of counterparty.
Existing Departments/statutory bodies **inheriting** functions	As for new departments/statutory bodies (see above), plus: • Disclose a notional consolidated financial report aggregating the new entity with the financial report of the transferor, including comparatives.
Existing departments/statutory bodies **transferring** out functions	• Statement of Accounting Policy: ➢ Accounting policy for restructure ➢ Classes of assets and liabilities for each material transfer, including name of counterparty ➢ Adjustments to asset/liability values as a result of the restructure

Other requirements for NSW departments/statutory bodies:

1. Complete assessments of the impact of all new accounting standards effective 1 July 2019, on their existing (pre-MoG) functions, including for administered activities.
2. Departments/statutory bodies transferring functions must post-MoG, to ensure sufficient information on the new accounting standards is transferred to the statutory body/department inheriting their functions.

AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*

AASB 5 *Non-current Assets Held for Sale and Discontinued Operations* (AASB 5), does not apply to transfers that meet the definition of a ‘restructure of administrative arrangement’ under AASB 1004.

Providing Information to other Departments/Statutory bodies

NSW departments/statutory bodies transferring functions out are required to provide sufficient information to the transferees in respect of the disclosures required under TPP 09-3.

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