Local government financial management regulation changes

Western Australian local government position paper 2

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This position paper provides guidance on the application of the changes by the Department of Local Government, Sport and Cultural Industries (DLGSC) to the Local Government (Financial Management) Regulations 1996 (FM regulations).

The intention of the regulatory change is to reduce cost and reporting burden on local government entities (LG entities) by simplifying and removing requirements for revaluation of certain asset classes, and to address recent changes in accounting standards for leases, particularly right of use (ROU) assets. At this time, temporary relief is provided by the Australian Accounting Standards Board so a choice must be made as to the sector-wide approach for 2019-20.

Summary of changes

The changes to the FM regulations are:

- To simplify reporting and to reduce the cost burden of valuations, for local government owned assets:
    - Plant and equipment - the requirement to revalue plant and equipment type assets has been removed from the FM regulations – this asset category must be carried at depreciated cost.
    - Land, buildings, infrastructure and investment property must be carried at fair value, now revalued on a 5-year cycle (rather than 3-yearly), unless fair value is materially different from the carrying amount.
- To comply with the new requirements under Accounting Standard AASB 16 *Leases*, ROU assets (controlled but not owned by the LG entities) are:
    - Commercial leases (e.g. offices, vehicles, machinery, ICT equipment) – to be brought onto balance sheet by recognising the ROU asset and corresponding liability. The change to Regulation 17A would require these to be at cost rather than to be continuously revalued.
    - Concessionary leases ('peppercorn leases'), such as vested crown land and other land, such as land under roads, which is not owned by the LG entity, but which is under its control or management – concessionary lease ROU asset to be reported at zero cost.
        - Improvements on concessionary land leases such as roads, buildings or other infrastructure are to be reported at fair value, as opposed to the land underneath them, which will be at zero cost. This is a departure from AASB 16 which would have required the entity to measure any vested improvements at zero cost. LG entity feedback to DLGSC is that it is important to retain fair value for vested improvements on vested land.
        - Initial application in the 2019-20 year avoids restatement of comparative information.
        - Regulation 16 has been removed as it is redundant.

Application of main proposed changes

Plant and equipment

The proposed change to Regulation 17A requires plant and equipment type assets to be measured under the cost model, rather than at fair value. LG entities should transition to the cost model from the beginning of the current 2019-20 year. If a LG entity has already carried out a valuation exercise during the 2019-20 year and would like to book the valuation it can do so. However, the proposed regulation requires LG entities to refrain from obtaining valuations on plant and equipment in future years and instead continue with depreciated cost.

Changes to accounting standard for leases

The other main change to Regulation 17A results from recent changes to the accounting standard for leases - AASB 16. The new standard requires all leases (other than short term leases, low value leases and concessionary leases at zero cost) to be included by lessees in the balance sheet – that is, to recognise the ROU asset, and the corresponding liability. This change has been broadcast for some time, and may show a significant balance sheet impact for some entities.

The changes by DLGSC to Regulation 17A specifically require all ROU assets (other than vested improvements which are to be measured at fair value) to be measured at cost. This means all ROU assets under zero cost concessionary land leases are to be measured at zero cost (i.e. not included in the balance sheet), as opposed to fair value.

Regulation 16 had not permitted the inclusion of land under roads or land not owned by the LG entity but otherwise under its control or management, unless it was land under golf courses, showgrounds, racecourses or any other sporting or recreational facility of State, or of regional, significance. These proposed regulation changes will mean all vested land will be treated the same.

Some practical implications for LG entities

The removal of the Regulation 17A requirement to fair value *all* assets eliminates the previous departure from Australian Accounting Standards (i.e. the non-inclusion of vested land under roads at fair value), because the non-inclusion of vested land under roads as per Regulation 16 is consistent with AASB 16 measurement of concessionary lease ROU assets at zero cost.

Also, AASB 16 measurement of concessionary lease ROU assets at zero cost is consistent with the inclusion of vested land under golf course, etc. as per Regulation 16 at zero cost. Therefore AASB 16 measurement of concessionary lease ROU assets at zero cost is consistent with both inclusion (at zero cost) and non-inclusion of vested land. Therefore, Regulation 16 is now redundant and has been deleted.

LG entities need to account for the removal of the vested land values, such as those associated with golf courses, etc., by removing the land value and associated revaluation reserve at 1 July 2019. The previous year amounts will be retained as the modified retrospective approach of transition to AASB 16 does not require comparatives to be restated in the year of transition. The changes should be appropriately disclosed in the notes to the financial statements.

If subsequent to being granted the vested land by the State Government, the LG entity has constructed improvements (e.g. a building or a road) on the vested land, the LG entity will continue to recognise the improvements at fair value in its financial statements. This is also the case for the scenario in which the State Government vested land together with pre-existing improvements (e.g. a building or a road) to the LG entity. In this case the LG entity should measure the concessionary lease ROU asset of the vested land at zero cost, but the vested improvements at fair value.