

**Proposals Arising from the Short-term  
Review of the Requirements in  
AAS 27, AAS 29, and AAS 31**

**Submission by**

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# Short-term Review of AAS 27, AAS 29 & AAS 31

## INTRODUCTION

Our firm provides specialist financial and administration consulting services solely to Local Government throughout Australia. Our senior principal, David Maxwell, is a Fellow of the Institute of Chartered Accountants and an Associate of Local Government Managers Australia with over 28 years experience as Local Government Auditor, Principal Accounting Officer, Chief Executive Officer and Consultant.

Under the name Coalface Software Solutions - who supply a range of spreadsheet templates to assist Council officers in the preparation of the Annual Financial Statements - we have been contracted by the Local Government Association of South Australia to prepare the Model Financial Statements for use by Councils in that State. Coalface Software Solutions prepares Annual Financial Statements template formats to comply with legislative and reporting requirements for New South Wales, Northern Territory and South Australian Councils.

Coalface Software Solutions sponsors the NSW Annual Financial Statements Award presented by the NSW LGMA Financial Professionals Group, judged by nominees of the NSW Local Government Auditors Association, Finance Professionals Group and Coalface Software Solutions.

Our comments are directed principally in relation to Local Government. There are no matters that we request be treated in a confidential manner.

## GENERAL

We recognise that Exposure Draft ED156 results from the short term review of AASB 127, AASB 129 and AASB 131 following the Board's decision to move to transaction-neutral standards, and it is therefore desired to limit substantive changes. However, there were a number of minor changes proposed in ED 125 *Financial Reporting by Local Governments* released in October 2003 that, in our view, could well be incorporated into these proposals without breaching that limitation.

We note that of the total number of entities that will need to apply the proposed changes to the standards, some 600 - 700, by far the majority, are local governments. Many of these have difficulty in attracting and retaining qualified accounting staff, and we submit that it is important that these users are able to clearly identify the matters that apply to their entity, and hence to correctly apply the relevant standards.

## AASB 10XX *Administered Items*

### Specific Matters for Comment

We support the limitation to government departments given the short-term nature of the current project, and the proposals for specific disclosures.

The drafting of the proposed standard indicates the range of different arrangements that exist, and the difficulty in clearly delineating between the different types of arrangement. A similar type of difficulty relating to distinguishing a change in accounting policy from a change in accounting estimate is specifically referred to in AASB 108.35, which directs that the change is to be treated as a change in an accounting estimate.

We suggest that it would be appropriate to similarly indicate a "default treatment" in cases of difficulty in determining whether financial transactions should be recognised or disclosed. We see this as an interim measure pending the "extensive guidance" referred to in paragraph BC14.



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Review of “Administered Items” - In the absence of information indicating that substantial groups of financial transactions are being omitted from financial reports, we suggest that the review should receive a low priority. We consider that this review should be conducted in conjunction with the proposed review of control in the public sector.

We are of the view that certain groups of transactions involving local government could fall within the definition of administered items. These largely relate to federal government initiatives that use local governments in lieu of State governments as the vehicle, a process that we suspect will increase. At this stage it appears that these items are (a) being recognised by the local governments, and (b) do not materially affect the financial reports.

## **AASB 10XY *Land under Roads***

We note that “*the purpose of the transitional provision for land under roads in paragraph 6 is to provide an adequate period within which interested parties can address concerns about the reliable measurement of land under roads*” (paragraph 7). We submit that these concerns have not been adequately addressed, and that the identical circumstances that justified the introduction and extensions to the transitional period still exist.

Having said that, we support that any adjustment arising from recognition should be directly recognised in equity.

We submit that the substance of paragraph BC22 should form part of the Standard. It is not, in fact, a reason leading to the conclusion reached by the Board, but a recognition that identifying the *fair value at the time of acquisition* for all parcels of land (acquired at no or nominal cost) under public highways will not always be practical.

It therefore fulfils the identical purpose to paragraph G3 proposed to be inserted into AASB 116 *Property, Plant & Equipment*.

Further, we submit that the Standard should acknowledge that it may be impracticable to determine the original cost of many parcels of public highway land that were acquired other than for no or nominal cost many years ago.

## **Definition of Land under Roads**

We submit that the definition should be amended to read as follows:

***land under roads:*** *separate parcels of land principally used for the purposes of roadways, footpaths, nature strips, median strips and associated road infrastructure works.*

Land that contains a roadway that is incidental to another use of the land should be recognised at cost or at a fair value that is related to the principal use of the land. The concerns about reliable measurement have all related to land the **sole or principal use** of which is for roadways, footpaths, etc.

## **AASB 10XZ *Disaggregated Disclosures***

As an interim measure we accept the decision to separately state the requirements for local governments and government departments. However, we consider the decision to include *disaggregated disclosure* requirements in the proposed Whole of Government standard to be inadequately supported, and apparently contradicts the transaction neutral policy of the Board.



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We question the proposal in paragraph 15 to require disclosure of liabilities as well as assets. This contrasts with the requirements for local government (paragraph 9(a)(ii)), and the difference in requirements should be separately supported in the *Basis for Conclusions*. As the requirement for disclosure of both assets and liabilities is additional to those currently in AAS 29, we submit that paragraph 15 should merely require disclosure of assets. The question of disclosure of liabilities - for types of entities - can then be addressed in the foreshadowed *Disaggregated Disclosures* review project.

In relation to the cost aspects of providing the disaggregated information relating to assets, we report that local government experience has been that most accounting systems have coding facilities adequate to the purpose, and after initial setup maintenance costs are minor.

Review of "Disaggregated Disclosures" - We suggest that this review should be undertaken in the medium term, with a view to a revised Standard commencing (say) 1 July 2011. We submit that the revised Standard should have substantially common disclosure requirements, with specific guidance for identifying functions/activities for different types of not-for-profit entities.

## **AASB 3 *Business Combinations***

We support the proposed clarifications to the definition of *reporting entity*.

We consider that AASB 3 and AASB 5 are inappropriate for the purposes of most local government restructures, and address this matter separately below.

## **AASB 116 *Property, Plant and Equipment***

### **Recognition of Assets**

We concur in principle with the proposed insertion of paragraphs G1 - G3 in relation to heritage assets. However, as referred to above, similar difficulties arise in relation to land under roads, and the proposed wording should be modified to also refer to land under roads.

We submit that land under roads similarly has usually unlimited useful life, but should be subject to impairment testing.

Paragraph BC22 reports the Boards view - with which we concur - that "land under roads should not be required to be recognised and measured at current fair value." We submit that the Board should express a similar view in relation to heritage assets.

The Board should also address the situation where a reporting entity elects to recognise (previously unrecognised for the reasons given in paragraphs G1 - G3) heritage assets and land under roads at fair value in accordance with paragraph 29 of AASB 116<sup>1</sup>. The options would be that any adjustment arising should be made either to accumulated surplus as provided by paragraph 9 of proposed AASB 10XY, or be made to asset revaluation reserve.

For circumstances where items that meet the definition of assets are not able to have an original cost or fair value reliably attributed, we are of the view that they should be regarded as being recognised with no value attributed (i.e. at NIL value), rather than not being recognised.

This approach both ensures that such assets are regarded as being subject to the accounting standards, but would require, in the above example, that the adjustment is made to asset revaluation reserve.

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1. This decision may be made some years after the end of the transition period referred to in AASB 10XY.

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## Disclosure of Assets Recognised at NIL Value

We suggest that AASB 116 paragraph 74 should be amended to require disclosures in relation to assets recognised at NIL value. We would envisage a narrative summary of the nature and significance of such assets.

## AASB 127 *Consolidated and Separate Financial Statements*

We concur with the proposed amendments.

Review of “control in the public sector” - We suggest that the review should receive a low priority, and consider that it should be conducted in conjunction with the proposed review of administered items.

## AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*

We concur in principle with this amendment. However, we suggest that the scope currently can be regarded as being too broad, and that the exclusion should be limited by including the words “*that have not been actuated at the date of authorisation for issue of the financial report*” after the word “intent”.

It is our view that (say) an election promise relating to an obligating event that occurs prior to reporting date should be recognised if the appropriate legislation is enacted prior to the date of authorisation for issue of the financial report. Once the promise is put into effect, it loses its status as a promise and becomes a fact.

(An alternative amendment could be the insertion of the word “*un-executed*” before the words “public policies”.)

## AASB 1004 *Contributions*

### Control over Involuntary Non-reciprocal Transfers

Notwithstanding the short-term nature of this project, we submit that progress made in the former review of AAS 27 (including the release of ED 125) should be incorporated. In this regard, the proposal in paragraph 8.4.3 of ED 125 that overpaid rates subject to a right of refund be recognised as liabilities should be retained.

Rates are levied on the valuation (plus base or minimum amounts if applicable) irrespective of the amounts, if any, paid in advance. The payment of amounts in advance does not in any way alter Council’s entitlement to revenue in any subsequent year. For any particular property, a Council is only entitled to receive rates that are levied in accordance with the Act, irrespective of the time of payment. We suggest that the correct amount of revenue to be recognised is the rates revenue actually levied by Council.

We do not understand the reason for the difference in the following two sentences from paragraph 25:

- “Where the transfers arise from a periodical charge, such as a land tax, a government obtains control over the assets on the day on which the government becomes entitled to levy the land tax.”
- “Control over assets acquired from local government rates would be obtained at the commencement of the rating period or, where earlier, upon receipt.”

We submit that the internal consistency of the standard would be improved by combining these sentences as follows:



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*“Where the transfers arise from a periodical charge, such as local government rates or a land tax, a government obtains control over the assets on the day on which the government becomes entitled to levy the periodical charge.”*

The proposed restructure of local government in Queensland raises a further issue in relation to the timing of recognition of involuntary transfers which the enabling legislation has not directly addressed. The restructure will come into effect shortly after 15 March 2008, some 258 days after the commencement of the financial year. Old entities have levied rates for the full financial year, and new entities will not be able to levy rates for periods prior to 1 July 2008. In this case, there is no right of refund attaching to the *pro rata* proportion of rates attributable to the new entity operations, and so the old entities will need to recognise all rates they have levied, even though more than 25% of these amounts are attributable to a period after the local government has ceased to exist.

## Liabilities Assumed by Other Entities

We note that the discussion contained in paragraph 35 relates to long service leave in relation to government departments, but the possibility of assumption of liabilities is not limited to these situations.

Section 3(2) of Part 2 of Schedule 9 to the NSW Local Government Act 1993 (as amended) specifically provides for the assumption of liabilities of the Cudgegong (Abattoir) County Council to Mudgee and Rylstone Shire Councils.

Although these circumstances are extremely rare other than as part of a boundary adjustment - the Cudgegong exercise is the only one that we know of - they are certainly not impossible, and we therefore suggest that paragraphs 34- 38 should also apply to local government.

## Contributions of Services

We oppose the retention of this procedure for any level of government. Its application is only mitigated by the limitation to services that would otherwise be purchased and even this limitation does not go far enough. The limitation should be expressed as “purchased within the existing financial resources” of the reporting entity.

We oppose the recognition of fictitious revenue and expenses, and consider it provides opportunity for politically fraudulent distortion of financial reports.

## Contributions by Owners

We have particular difficulty with the use of the term “owners” in a government context other than in relation to government departments. In fact, given that the definition of *contributions by owners* includes the characteristics of entitlements to distributions and ability to be sold, transferred and redeemed, we consider the term to have little significance.

In a local government environment, the contents of paragraphs 43 - 49 are limited to the extremely rare situation where an entity controlled by a local government issues shares to the public. We suggest that the current wording of these paragraphs is not sufficiently clear to ensure that all local government users are able to make this interpretation.

Review of “Contributions” Standard - This project should be progressed without delay and IPSAS 23 *Revenue from Non-Exchange Transactions* should be used as the basis of the replacement standard.



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## CONSEQUENTIAL AMENDMENTS

### **AASB 5 *Discontinued Operations***

We submit that proposed paragraph Aus2.4 (which effectively replicates the wording of the existing paragraph) reflects a significant misinterpretation of the nature of most local government restructures, which we deal with in more detail below.

We believe that a restructure of local government areas is most nearly akin to a restructure of government departments, and that the relevant procedures should be co-located in the accounting standards.

In our view, the restructure of local governments does not carry any of the attributes of a sale, and the operations involved can only be interpreted in a very limited sense as being discontinued.

We submit that paragraph Aus2.1 should be amended to also exclude the effects of local government boundary changes.

## REQUIREMENTS ADEQUATELY ADDRESSED ELSEWHERE

### **Restructures of Local Governments**

We dispute the view that the general principles expressed in AASB 3, AASB 1004 or AASB 5 are appropriate for the restructuring of local government. Further, those principles are generally expressed in terms of exchange transactions, and in every local government restructure of which we are aware, the “transferor” entity has not received any recompense for the net assets “transferred”.

In every case, the “transfer” has been effected by way of legislative instrument - an Act of Parliament, regulation or notice in the Government Gazette.

#### Queensland Proposed Restructure 2008

This restructure, to take effect on or shortly after 15 March 2008, involves:

- 36 councils are retained with no boundary changes.
- 6 councils continue with changed boundaries.
- 114 councils are abolished<sup>1</sup> and new council areas established.

#### Northern Territory Proposed Restructure 2008

NT local government currently comprises 6 municipal councils, 1 council established by agreement under a mining tenement and 55 aboriginal community councils without rating powers. Currently 5% of the NT area is within local government boundaries, and only 2% is subject to local government rates. A major restructure is to take effect on 1 July 2008.

- 4 municipal councils and the council established by agreement under a mining tenement remain unchanged.
- 2 municipal councils and 55 aboriginal community councils are abolished.

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1. Local Government Reform Implementation Act 2007, section 5 (new section 159YD, definition *merging local government area*).



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- 9 new councils are established covering effectively the whole of the remainder of the State<sup>1</sup>.

Details of assets and liabilities to be transferred from the NT government to newly established councils are not currently available, but it has been made clear that there will be such transfers, and that the newly established councils will undertake the local government functions previously discharged by the Territory government.

## NSW Boundary Changes 2003 - 2004

These changes resulted in a net reduction of some 20 councils and were effected by way of notice in the NSW Government Gazette. We use the example of the formation of the new Albury / Corowa / Greater Hume Councils<sup>2</sup>, but all boundary changes used similar terminology and processes.

- The former areas of City of Albury, Corowa Shire, Culcairn Shire, Holbrook Shire and Hume Shire were “amalgamated so as to form new areas having the names of the City of Albury, Corowa Shire and Greater Hume Shire”.

(The former areas were thus discontinued, and even though 2 of the new councils bear the same names as 2 of the predecessor councils, the new councils were totally different legal entities.)

- Portion of the area of the former Holbrook Shire was transferred to Tumbarumba Shire, and this legal entity continued with the amended boundaries.

We restate our view that a local government restructure is most akin to a restructure of the government departments, the only difference being that in the latter the restructure involves the functions that the various departments administer, while in the former it is the **area** that changes, but the local government functions remain unchanged. And in the NT example, we can see that such a restructure can also involve the transfer of assets/functions from a State/Territory government to local government.

We therefore submit that the principles to be adopted should be substantially the same as those adopted for the restructure of administrative arrangements of government departments, and that these should be included in AASB 1004 immediately following paragraphs 50 - 55. We submit that the wording in paragraphs 7.1 & 7.2 of ED 125 would form a suitable basis for drafting.<sup>3</sup>

We strongly hold the view that the net change on restructure should NOT be reflected in the Income Statement of the predecessor / successor entities.

## **REQUIREMENTS NO LONGER ADDRESSED**

We support the proposal not to retain guidance on performance indicators. The *Nationally Consistent Frameworks for Local Government Financial Sustainability*, adopted by the Local Government and Planning Ministers' Council, include a number of identifiable indicators that include - but also extend beyond - the financial indicators previously included in AAS 27.

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1. As far as we can make out, the *Yulara* area will remain unincorporated under the Local Government Act.
  2. NSW Government Gazette No 90. 26 May 2004.
  3. In discussions with local government practitioners occurring about the time of ED 156, we found strong support for these proposals.



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Review of Performance Indicators - we submit that this should not be proceeded with in relation to local governments as other industry bodies as other industry bodies are undertaking similar reviews of wider scope that include the area of the proposed AASB review.

We shall be pleased to supply any further information that you may require.

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