



LOCAL GOVERNMENT CODE OF ACCOUNTING PRACTICE & FINANCIAL REPORTING

SUBMISSION RELATING TO PROPOSED UPDATE #10

1. Introduction

The NSW Code of Accounting Practice was introduced concurrently with the adoption of Australian Accounting Standard AAS 27 "Financial Reporting by Local Governments" effective from 1 January 1993. Pursuant to clause 18 of the Local Government (Financial Management) Regulation 1999 the Code is a prescribed standard for the purposes of section 413 (3) of the Local Government Act 1993 (as amended).

The Code is updated regularly and the current edition includes update #9 issued May 2001. A draft version of the proposed update #10 has been issued for comment. We have reviewed the proposed changes and submit our comments in no particular order.

In this submission we have addressed only those matters where we believe further change should be made.

2. Timing

We commend the Department on the obvious efforts being made for the early issue of update #10. However, we submit that, as a general policy, a Code Update should not be issued any later than the end of February of the year in which the changes are to **commence** to take effect.

3. Definitions - Cash Assets

We disagree with any reference to "*bank borrowings, such as bank overdrafts*" in this definition. Bank overdrafts are borrowings and must be disclosed in the liabilities section of the Statement of Financial Performance (unless the provisions in AAS 23 relating to set off of debt apply).

If desired, the definitions from AAS 36 can be adapted to read "*cash assets means cash on hand and highly liquid investments with short periods to maturity which are readily convertible to cash on hand at the investor's option and are subject to an insignificant risk of changes in value*". Reference to "*bank borrowings, such as bank overdrafts, which are integral to the cash management function and are not subject to a term facility*" is appropriate in the definition of **Cash Management**.

Discussion of types of investments that may or may not meet the definition of Cash Assets would be appropriate in Chapter 6. Such discussion may well refer to the appropriate treatment of Managed Funds and Negotiable Certificates of Deposit.

4. Definitions - Current Assets

The proposed Note 22 requires that Councils state the purpose for which each reserve has been established, and in many cases it will be clear that the proposed expenditure will not occur during the next reporting period.



While we recognise that such reserves may be modified by Council resolution at any time, we consider that the purpose of the Annual Financial Statements is to report the situation **as at the reporting date**, and that investments supporting internal restrictions of greater than 12 months should also be reported as non-current. Subject to AAS 8 “Events Occurring After Reporting Date” any Council resolution to change the purpose or reduce the term of the restriction lies in the future.

We submit that the words “(eg by proposed expenditure included in the current Management Plan)” should be inserted after “12 months” to indicate the normal means of demonstrating the shorter period of restriction.

5. Section 3.2 - Application of Australian Accounting Standards

Although technically the narration is exactly correct, recent handbook issues by the accounting profession make it clear that the dual numbering of “AAS” and “AASB” previously adopted is now being abandoned, and that the “AASB” sequence will be used except for the few “AAS” that relate only to non-corporate bodies.

We suggest that a conversion table from “AAS” to “AASB” be included in the Code, and that all references to “AAS” be followed by the relevant reference to the “AASB” number, where this applies. The table should explain that the referent AASB is effectively a paraphrase of the AAS.

We have prepared a conversion table and posted it on our website www.coalface.com.au where it is available for download.

6. Section 4.8 - Statement of Cash Flows

We suggest that policy 4.8.5 be amended by inserting “*current and non-current*” after the words “*cash assets*” first appearing.

We suggest that the last sentence in the fourth dot point on page 4021 should read “*Few liabilities other than bank overdraft would be included in the definition of cash adopted in the Standard*”.

7. Section 5.1 - Requirements for Presentation of Example Notes

We oppose the amendment to policy 5.1.2 to require the preparation of notes 2 to 22 inclusive even if there are nil returns.

After careful consideration, we are unable to identify any benefits for any individual Council, or for a user seeking to ascertain a Council’s use of its scarce resources. The waste of resources, however, is obvious.

The note relating to Extraordinary Items would only be an extraordinary occurrence, because that is the definition contained in the Standard; most Councils will hope that they never have cause to use a note explaining the correction of a Fundamental Error. In both cases, the Statement of Financial Performance will clearly disclose whether there is a need for either note and to require the inclusion of NIL notes seems absurd. It is important to recognise that the Annual Financial Statements are prepared in accordance with a set of principles expressed in the Australian Accounting Standards - they are **not** prepared in accordance with a formula.

Under the Australian Accounting Standards, it is perfectly proper procedure to insert additional notes if special circumstances arise and the amount is sufficiently material so as to require the insertion of the additional information in order to provide a true and fair view of the operations of the Council during the reporting period. One such type of circumstance that may occur is the restructure of local governments, and examples of the type of disclosure are given at pages 1480.8 & 1480.9 of AAS 27, but this is not the only type of special circumstance which may require additional disclosure.



By insisting that notes 2 to 22 be prepared even if there are NIL returns, **the Code is effectively directing Councils NOT to consider the provision of any additional information under any circumstances.**

It may be that the unintended omission of notes is considered to be a problem. To some extent this will always occur due to the human error factor. Other human errors that can only be minimised but never eliminated include the failure to renumber subsequent notes if an earlier one is not required and the duplication of note numbers. It may be that revising the existing numbering sequence will help to reduce these occurrences and achieve presentation in a more systematic manner (AAS 37/AASB 1034 para 4.5).

We offer the following for consideration

Proposed Note No	Description	Current Note No
1	Significant Accounting Policies	1
2	Functions	2
3	Expenses from Ordinary Activities	3
4	Revenues from Ordinary Activities	4
5	Conditions Over Unexpended Grants & Contributions	17
6	Disposal of Assets	5
7	Cash Assets & Investment Securities	6
8	Receivables	7
9	Financial Instruments	15
10	Inventories & Other Assets	8
11	Property, Plant & Equipment	9
12	Liabilities	10
13	Reserves	22
14	Statement of Cash Flows Reconciliation	11
15	Statement of Performance Measurement	13
16	Commitments for Expenditure	12
17	Material Budget Variations	16
18	Statement of Contribution Plans	17
19	Joint Ventures & Associated Entities	19
20	Assets & Liabilities Not Recognised	18
21	Correction of Fundamental Error	21
22	Extraordinary Items	22

Based on our inspections of a number of statements, we would expect “gaps” in the sequence on very rare occasions. Other than a possible re-swapping of notes 3 & 4, we would not envisage future need to make significant changes to this sequence.

Alternatively, may we suggest that all Notes omitted must be specifically reported in Note 1, together with appropriate information of the reason for non-application?



8. Section 5.5 - Revenue from Ordinary Activities

On 3 December 2001 we made a formal submission to the Accounting Advisory Group seeking revision of the disclosure of payments received from other levels of government. A copy of our submission is posted on the website at www.coalface.com.au and we do not repeat the detailed arguments here.

The key to our submission is that to “users who are prepared to exercise diligence in reviewing those reports and who possess the proficiency necessary to comprehend the significance of contemporary accounting practices” (SAC 3, para 36), the key information relates to the likelihood of future funding - ie. whether the payments are recurrent or non-recurrent. **The current prescribed method of disclosure omits the most valuable information of all.**

Accordingly, we recommend:

1. that all revenue amounts received from other levels of government be described as “payments from other levels of government” (this accords with the treatment given in AAS 27).
2. that payments from other levels of government be sub-classified between Recurrent (Untied, Special Purpose) and Non-Recurrent, and (subject to materiality) no further sub-classifications.
3. that Section 94 contributions, Section 64 contributions and other contributions each be disclosed as single line items (subject to materiality) within the classification “Other Revenues”.
4. that the above items be cross-referenced to Note 5 - Conditions over Unexpended Grants and Contributions, and in the case of Sec 94 & 64 contributions, also cross-referenced to Note 18.
5. We would define *recurrent amounts* as those where the Council has a reasonable expectation of receiving a broadly similar amount for similar purposes in each of the next three reporting periods. For audit purposes, this is testable by identifying the amounts in the current Management Plan.

9. Section 6.2 - Classification of Assets

In view of the Accounting Advisory Group comments on page 4 of the minutes of the meeting 14 February 2002, policy 6.2.4 (b) may be amended to replace the words “revenue reserves” with the words “internal restrictions”. (But see also our comments in paragraph 11 below.)

10. Section 6.4 - Measurement of Assets - Revaluations

We understand that it is possible that paragraph 8.2 of AAS 36 / AASB 1040 may shortly be amended to remove the requirement to disclose current valuations, and that policy 6.4.1 may accordingly be amended. However, we believe that there is a policy matter which needs to be addressed.

The Accounting Standard requires the **disclosure** of the amount of a current valuation not more than 3 years old, but it does **NOT** require the incorporation of those valuations in the books of account.

The proposed policy 6.4.1 requires the incorporation of the valuations in the books of account, removing the option available in the Standard.

We believe that it is desirable that the accounting requirements for Local Government continue to be aligned as closely as possible to commercial procedures in order to facilitate the transfer of additional skilled finance staff to Local Government. The reasons for any divergence from the Australian Accounting Standards should therefore be fully substantiated, clearly documented and subject to continual review so that the divergence can be removed as soon as the particular purpose ceases to exist.



Where *disclosure only* is made, and in a low inflation environment, it may be acceptable to a Council and its Auditor that some of the current valuations be determined by Council staff, possibly on a formula basis, and at a far lower cost than engaging professional valuers. Where the valuations are incorporated into the books of account, a higher level of valuation independence may be required.

11. Section 8 - Accounting for Equity

On 3 December 2001 we made a formal submission to the Accounting Advisory Group seeking the disclosure of revenue reserves in the Statement of Changes in Equity, similarly to normal commercial and interstate practice. A copy of our submission is posted on the website at www.coalface.com.au and we do not repeat the detailed arguments here.

With respect, we have difficulty appreciating the reasoning of the Group, and believe that the earlier proposed amendments should be retained.

Notwithstanding this, we believe that some of the wording could be confusing. We suggest that the second sentence in policy 8.1.3 should read "*Disclosure of reserves other than the Asset Revaluation Reserve in the Statement of Changes in Equity is optional*". We suspect that the reference in the first line of the third paragraph on page 8002 should be to the *asset revaluation reserve* rather than the *asset replacement reserve*. We feel that the following may assist in clarifying the meaning of *revenue reserves*.

"This Code requires that all reserves other than asset revaluation reserve be backed by Cash Assets or Investment Securities. To establish these reserves, Councils must first raise revenues, collect the funds and then reserve the cash for a particular purpose. For this reason, the reserves are called *revenue reserves* even though their purpose may be to fund some future capital expenditure."

"In local government, etc.

While we support the disclosure of revenue reserves in the Statement of Changes in Equity, the existing format would require significant redrafting to achieve this. We interpret the Code to prescribe the format of the four principal Statements (unlike the Example Notes, which are guides only) and believe that many in the industry share our interpretation.

12. Section 9.5 - Allocation of Direct and Overhead Costs

If it is now the intention not to require separate disclosure of a Governance function on Note 2 until an agreed definition of eligible costs has been achieved, it could be clearly stated in policy 9.5.2 that this is the case.

13. Appendix A11 - Management Plans & Budgeting

We strenuously oppose the proposal to require the submission of two annual operating budgets to the Department before 31 July. In so doing, we do not suggest that all Councils are preparing their budgets in accordance with best practice, or that there is not scope for significant improvement in commonly applied practices. But we are strongly of the view that the proposed measure is not appropriate.

We are strongly of the view that depreciation must be included in all budgets. In our view, a Council that has failed to do so will need to disclose this fact in Note 16, and indeed it should be obvious from the Statement of Financial Performance and Note 2 that this is the case. In our view, a Departmental "please explain" directed to the Council, or if necessary direct to the Mayor, should be sufficient to prompt compliance in future years.



We are strongly of the view that budgets should separately quantify the amounts of wages and other expenditures by type. In our view, a manpower budget is an essential start point in the budgeting process. The mere submission to the Department of a budget as proposed will do nothing to encourage the adoption of more appropriate budgeting processes. Councils who fail to use appropriate procedures will simply fudge the numbers in July of each year, rather than in the course of preparation of the Annual Statements.

In contrast to commercial enterprises, purchase of new fixed assets commonly amounts to 25% - 30% of total cash outflows (a sample of over 70 Council 2000 statements showed a range from 12.15% to 54.92%, with a median value of 25%). Council budgets must necessarily include proper provision for all expenditures - capital and operating, and particularly in respect of capital, must properly identify sources of funding.

A major area - probably the major area - of expenditures for most Councils is roadworks construction & maintenance funded by State and Federal Government. Our submission dated 3 December 2001 highlights a number of areas in which the nature of the amounts received (i.e. the nature of the works undertaken) varies substantially from year to year, although there is usually less variation in the total of the amounts received. These variations inevitably change the Net Result in the Statement of Financial Performance.

Despite the change in philosophy in the 1993 Act, elected members in many smaller Councils - and in some larger ones, too - have not come to terms with the changed management structure with the result that the General Manager exerts only nominal influence over senior works personnel. If these personnel are not willing to define projects for the full budget period, and then estimate the different cost components involved in executing those works, both the General Manager and finance staff find it extremely difficult to obtain redress.

In our experience, RTA funding processes and the approach adopted by some of their officers also tend to work against the early definition of specific projects, the analysis of cost components and the allocation of these between capital and operating expenditures.

The first responsibility of management is to ensure that the organisation does not become insolvent, and insolvency is always defined in relation to the ability to pay debts as and when they fall due. A Management Plan must therefore always be heavily influenced by the cash implications of proposed actions. A Management Plan that properly accounts for all expenditures and funding sources, and which is balanced to a NIL net cash movement may show a Net Surplus or a Net Deficit of \$1,000,000 in the Statement of Financial Performance.

But such a result does not mean that the Management Plan is incorrect or invalid. Given the fundamentally cash nature of a Management Plan, **we have significant doubts that concentrating on budgets relating to the Statement of Financial Performance and Note 2 is appropriate.** Indeed, in the long run it may detract from the need to properly budget for all expenditures and revenues of all types. In our view, a budget limited only to Statement of Financial Performance components is incomplete and usually misleading. It is totally inappropriate as a management tool.

In probably most Councils in the State, the officer responsible for the preparation of the Management Plan is also responsible for the preparation of the Annual Financial Statements, and would be the same person who would have to adapt the Management into whatever two formats are prescribed for submission to the Department. The same officer usually has direct responsibility for accurately incorporating the budget into the general ledger system, and supervisory responsibilities for the issue of rates notices.

We question whether the identified problem of late conversion of part of the Management Plan to revenue/expenditure types, or the omission of depreciation, in those Councils where it occurs is sufficient to warrant the proposed measure.



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We also question whether the use to which this data would be put would justify the undoubted cost of its collection, but we have not identified any information that suggests that it would be used in any way at all.

If Auditors are experiencing problems due to the late conversions of budgets by Councils, could they not review the current year budgets (ie. in converted format) as a specified part of their mid-year audit?

14. Minor Items

Definition - Investments - include cross reference to appendix A10.

Application of Australian Accounting Standards - UIG Abstracts 36 - 39 have effect for reporting periods ending before 30 June 2001, Abstracts 40 & 41 after 30 June 2001.

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

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