

**NSW CODE OF
ACCOUNTING PRACTICE &
FINANCIAL REPORTING**

UPDATE #15

Submission by

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DRAFT UPDATE #15 - NSW CODE OF ACCOUNTING PRACTICE & FINANCIAL REPORTING

INTRODUCTION

The draft of update #15 to the NSW Code of Accounting Practice and Financial Reporting was released on 25 May 2007, with closing date for submission being 7 June 2007. We submit that the period for comments is unduly short, and welcome the proposal in the Department's invitation for expressions of interest for earlier releases of drafts of Code updates in future years.

Due to the extremely short period for comments, we have been unable to undertake a comprehensive review of the draft Code update, but we report those matters that have come to our attention during a cursory review.

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We submit that it should be unnecessary to supply NIL notes, and this conflicts with normal accounting practice, and the practice adopted in other jurisdictions. There are numbers of Councils who will be reporting NIL values in Note 14 *Investment Property*, Note 17 *Developer Contributions*, or Note 19 *Interests in Joint Ventures*.

We submit that the Notes should be re-sequenced such that the compulsory Notes are numbered before those that significant numbers of Councils will not need to supply. Users will quickly adjust to changes in numbering sequence. At the very least, we submit that the narration should indicate that Notes with NIL values may be combined with preceding or subsequent Notes onto a single sheet.

This comment also applies to the note at the bottom of page A21.

Balance Sheet - page A-14

We submit that the presentation of certain current assets and current liabilities does not comply with AASB 101(52) shown on page A15 as comment 5.

Cash Flow Statement - page A19

The Cash Flow Statement shows a cash inflow of \$2,000 from boundary adjustment - and we challenge whether this item would be an investing activity; the cash flow reconciliation (page A83) shows a positive reconciliation item of \$8,000; the Income Statement does not disclose either revenue or expense from boundary adjustment as required by AAS 27.75; there is no Note providing example disclosures for a boundary adjustment.

Note 1 - page A23 - item (c)(iii)

We submit that this Note should disclose the *names* of the jointly controlled assets/entities, and that the wording here should be amended to make this requirement clear.

Note 1 - page A26 - item (k) - subsequent measurement

Our interpretation of the Minister's investment order is that all investments are to be in Australian currency. We submit that the third paragraph is inappropriate.



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Note 1 - page A26 - item (l)

As this relates to financial instruments, we submit that it should form a subordinate part of item (k).

Note 1 - page A29 - item (v)

We suggest that the drafting in this note does not make it sufficiently clear that the first four paragraphs relate to restoration undertaken at the end of the asset's useful life, while the last 3 paragraphs refer to rehabilitation conducted systematically over the life of the operation.

We are concerned that inexperienced users may consider the second procedure as acceptable where the restoration is undertaken at the end of the asset's useful life.

We also question whether unwinding of present value discounts are likely to be material where rehabilitation is conducted systematically over the life of the operation.

We submit that the discussion of the alternative treatments should be included in relation to Note 21 as a discussion item, with a cross-reference back to Note 1 referring to the need to amend the description of the accounting policies adopted.

Note 1 - page A30 - item (x)

We draw to your attention the apparent inconsistency between this item and commentary paragraph 35 page A36.

Note 1 - page A30 - items (z), (bb) & (cc)

As these items relate to the recognition and measurement of particular types of infrastructure, property, plant & equipment, we submit that they should be relocated to form subordinate sections of item (m).

Note 1 - page A30 - item (cc)

We draw your attention to the policy conflict between item (bb), where assets are recognised because Council retains operational control, and item (cc) where assets are stated to be recognised on the basis of title.

Many Councils, in compliance with AAS 27.4, have for some years de-recognised RFS assets on the basis that they do not have control of them. (We became aware of the practice in 2003 and included example wording in our templates then, so we surmise that it was occurring for at least a couple of years before then.)

If it is the intention of the LGAAG to now mandate that these assets now be recognised on the basis of title, this should be made clear by the expression of a policy in the commentary, and guidance should be provided for those Councils that have previously de-recognised these assets. We understand that some Councils will have difficulty in obtaining details of the equipment and vehicles to which they have title, as this information is held on computers held at RFS regional offices, or in other locations to which Council staff do not have right of access.



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Note 1 - Commentary - page A31

We submit that a clear statement that the contents of Note 1 will need to be amended to accurately reflect the accounting policies adopted by each Council should be made at the head of this commentary. It should also be emphasised that Note 1 is entitled “summary of **significant** accounting policies”, and that there may be policy disclosures, not significant in the context of the overall financial statements, that may be required disclosures in other notes. (See AASB 101.112)

It should also be stated that accounting policies that had no effect in Council’s operations in the current or previous reporting periods should not be disclosed (e.g. finance lease recognition policy where Council had no finance leases in either reporting period).

Note 1 should be an **explicit** statement of the **significant** accounting policies used in the preparation of the accounts.

Note 1 - Commentary - pages A31 - A36

We submit that there should be minimal duplication between the commentary here and commentary in relation to other Notes, and that the relevant cross-reference (which should show the appropriate page number) to the other Notes is sufficient.

For example, while paragraph 19 (page A33) gives a cross-reference, paragraph 19a duplicates paragraph 21 on page A72. By duplicating the commentary there is a possibility that users may skip parts of the second version where there has in fact been no duplication. We submit that all commentary relating to a particular class of assets should be located together.

Note 2 - Commentary - page A38

There is an apparent conflict between paragraph 4 and AASB 111 (quoted in commentary Note 9, page A72, paragraph 10).

In the SA Model Financial Statements 2007 this was addressed by insertion of the following paragraph:

“In a local government environment, “administration and other general overhead costs” is interpreted to refer to governance and other general overheads that are unable to be attributed to functions. The distribution of costs that can be reliably attributed to the function undertaking the construction of an asset, are regarded as part of the construction cost.”

We have received verbal assurances from the Local Government Association of South Australia that they will permit other jurisdictions to use any of the contents of the SA Model Financial Statements for the purposes of that jurisdiction’s equivalents.

Note 3 - Income from Rates - page A40

Notwithstanding the disclosure in the Appendix to AAS 27, the valuation basis, frequency of revaluation and quantum of valuations are irrelevant in determining a Council’s rate revenue. The annotations at the foot of the page should be removed.



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Note 3 - Income from Operations - page A41

We cannot identify any guidance in the commentary in relation to which, if any, of the example revenue classifications are mandatory, and which are discretionary. The commentary should include, clearly identifiable, a statement that income descriptions should report only the most significant revenue sources, such that the *other* or *sundry* classification is less than 10% of the total, and that the descriptions given are merely for example purposes.

We draw to your attention that the *other* classification for user charges exceeds 25% of the relevant total. Similar comment applies to Note 4, pages A47 - A48.

Note 3 - Restrictions on Grants - page A43

We agree that these must reconcile to Note 6, but such reconciliation must also be possible in relation to opening and closing balances, as well as movements during the reporting period. Provision should be made here for the complete reconciliation by also including opening and closing balances.

Note 4 - Capitalised costs - page A48

We submit that the presentation here could be improved either by showing a subtotal or by showing the capitalised costs in brackets.

Note 4 - Depreciation, amortisation and impairment

It is our understanding that the asset class must be shown in relation to any impairment reversal, although we grant that such reversals should be exceedingly rare.

We submit that the reference to impairment reversal should be omitted, and instead appropriate notes inserted in the Commentary.

Note 6(b) - Investments - page A55.

1. The results of a search through the Accounting Standards for "available-for-sale" indicated that this term was only used in the Financial Instruments standards - *AASB 7, AASB 132 & AASB 139*. We submit that the financial instrument categorisations should only be referred to in the Financial Instruments note - Note 15 - as is the practice in the *XYZ accounts*.

Accordingly, this Note should list the various financial instruments by type.

2. According to our copy of Value AIFRS Holdings 2006 accounts (page 83) disclosures in the movements of the various categories of financial instruments is not mandatory, and should be removed from this Note as it impedes its ability to be easily read and understood.
3. According to our interpretation on the Minister's Investment Order, the Minister's approval is required prior to the purchase of any *listed equity securities*. Either the commentary should contain a note to this effect, or preferably, an alternative example should be selected.



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4. It is likely that *held to maturity investments* will include both current and non-current components. Particularly while users are grappling with the novelty of categorisation of financial instruments, it may be misleading to show all amounts as non-current. Some users may interpret this as suggesting that when a *held to maturity investment* becomes a current asset, it is re-categorised to *available-for-sale*.

Note 6 - Commentary - page A60 - A61

We suggest that the example amortised cost calculation could be clarified by clearly stating that the discount amortised equals the difference between interest income recognised (opening carrying value x market interest rate) and interest received in cash.

Note 6 - Commentary - page A64

Paragraph 3 may now be superfluous, or re-worded to refer to “prior to 1 July 2005”.

Note 8 - Tip & Quarry assets - page A70

A number of Councils have reinstatement/restoration/remediation liabilities that are not related to rubbish tips or quarries. We are not aware of any data collection sourced from the annual financial statements in relation to the totals of these separately, and from the statements submitted for judging in the Finance Professionals award, it would appear that these are generally non-material as a percentage of the total carrying values of IPP&E.

We submit that these should be combined, and described as *unexpired reinstatement (or restoration or remediation) costs*.

Note 8 - Commentary - page A73 - paragraph 16.

We interpret AASB 116.41 to *permit*, but not *mandate*, the revaluation surplus on an asset to be transferred to equity on disposal. If it is intended to mandate this procedure, it should be clearly stated as a policy.

The offsetting of revaluation increments and decrements within a class of assets may well make it impossible to determine the revaluations surplus, if any, currently existing in Asset Revaluation Reserve for any specific asset. We have made submissions to the AASB that AASB 116.Aus40.1 & 40.2 should be discretionary.

Note 8 - Commentary - pages A73 & A74 - paragraph 21 - (1)

When the staged recognition of assets was undertaken following the introduction of AAS 27, Councils were not required to revalue motor vehicles, office equipment, furniture and fittings and other plant and equipment replaced on regular basis. We submit that the same exemption should be provided in relation to the current round of revaluations. However, whether the exemption is provided or not, **it should be explicitly stated in the commentary.**



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Further, we submit that unexpired reinstatement etc. costs should also be exempt from revaluation - at least on a temporary basis - and that the LGAAG should establish a research project to develop appropriate industry guidelines for the purpose. We have studied the guidance provided as part of Interpretation 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* and have formed the opinion that this guidance does not sufficiently cover many of the situations frequently met in local government.

Note 8 - Commentary - pages A73 & A74 - paragraph 21 - (2)

Under the sub-heading *Future Revaluations* it is quite correctly stated that revaluations must be carried out whenever the carrying value is materially different from the current fair value. AASB 1031 *Materiality* includes the rebuttable presumption that a difference in excess of 10% of "base" value is material, and that a difference of less than 5% is not material. Guidance to this effect should be included in the commentary in this section.

This guidance could be strengthened by reminding users that in the 4 years from December 2002 to December 2006 the CPI for Sydney increased by 10.9% (from 140.4 to 155.8) and therefore that assets that change prices similarly to the CPI will require revaluation *at least* in the fifth year, if not earlier.

We submit that correct compliance with the accounting standards will ensure that Councils revalue assets with sufficient frequency as to prevent material mis-statements, and that it should not be necessary for the LGAAG to mandate specific revaluation periods. However, if that is the intention of the LGAAG, it should be clearly stated now, and further, whether a Council undertaking a voluntary revaluation in (say) the year prior to a mandated revaluation will have to make a further revaluation in the mandated year.

Note 8 - Commentary - pages A73 & A74 - paragraph 21 - (3)

We oppose the proposed indexation of water and sewerage asset values between formal revaluations. As stated above, correct compliance with the accounting standards will ensure that any mis-statement in carrying value should not exceed 10%, and the accuracy of the base data used for revaluations is no greater than that. Accordingly, indexation of a figure that may itself be in error seems an operation of super erogation.

However, if it is decided to persist with this proposal, we submit that the commentary must give clear guidance on the following points:

1. Whether the application of the index is regarded as a revaluation, and what effect if any, this is to have on the otherwise determined revaluation frequency.

AASB 116 permits only 2 methods of measurement of infrastructure, property, plant & equipment - cost and fair value. As the indexed amount is clearly NOT cost, it must be regarded as a form of fair value, yet it has been determined without reference to either market value or the actual current replacement cost.

2. Whether it is required that each individual asset's carrying value is to be varied by the index amount, or whether the indexation is to be applied to the total carrying value.



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The administrative workload for the former will be very significant. The latter has weaknesses in relation to the de-recognition of assets between full revaluations.

3. If the *NSW Reference Rates Manual for Valuation of Water Supply, Sewerage and Stormwater Assets* accurately reflects actual experienced costs by Councils, it will be possible to publish data confirming this on an annual basis. Some auditors may otherwise have difficulty in accepting these costs as a basis for calculating depreciated current replacement cost.
4. It is not clear from the text whether it is the indexing for water and sewerage assets that is being developed, or indexing for some other (unspecified) asset classes. If the former, we suggest that future indexation should be foreshadowed only, as coming into effect (which, as stated above, we oppose) after its development. If indices for water and sewerage assets has already been developed, details of where they can be accessed should be provided.

Note 8 - Commentary - page A74 - Impairment

The commentary under this head includes many items irrelevant to the impairment of infrastructure, property, plant and equipment - notably virtually the entire paragraph 22. However, assessing the impairment of unexpired reinstatement etc. costs has not been addressed, and should be.

Note 8 - Commentary - page A75 - example 1

While an impairment loss must be separately disclosed in the year in which it is recognised, there is no requirement to establish a separate *provision for impairment*¹, and conventional practice is to include it with *accumulated depreciation*. Some users, however, may interpret the example entry as requiring a separate accumulation account.

We submit that the words in the example entry *provision for impairment* should be replaced with the words *accumulated depreciation & impairment*.

Note 8 - Commentary - pages A75 & A76 - example 2

The worked example applies the proportion of accumulated depreciation to date (43.25%) to the current replacement cost of the network assets as calculated on the MEERA basis to become the new accumulated depreciation amount.

AASB 116 actually requires - and the most common wording in Note 1 policies states - that useful lives of assets are reviewed annually. There are very few Councils where this is actually being done, and hence a full revaluation provides an opportunity to require that this be done as part of the revaluation process.

We submit that it is in relation to useful lives of infrastructure assets that the greatest uncertainty - and hence the greatest scope for error - exists, and hence the formal review and assessment of remaining useful lives is one of the most important components of a revaluation. The pro rating of accumulated depreciation *may* be an appropriate practice if indices are applied *en globo* (see "Note 8 - Commentary - pages A73 & A74 - paragraph 21 - (3)" on page 7 above), but not for a full revaluation.

1. This terminology is itself out of date, as it does not meet the requirements of the definition of a provision in AASB 137.



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Further, the example does not address whether the accumulated depreciation percentage is to be applied to each of the individual assets within the asset class in the Asset Register. To do so would be wrong, as many individual assets would already be depreciated well past that point. But unless some adjustment is made to the assets, it will not be possible to reconcile between the Asset Register and the carrying value in the accounts.

We submit that the example is inappropriate for the procedures involved in a full asset revaluation, and should be replaced.

Note 9 - Provisions - page A77

We draw to your attention that AASB 137.11(b) refers to accrued vacation pay as an *accrued expense*. However, we have no objection to the retention of the traditional disclosure.

Note 9 - Movements in provisions - page A78 - (1)

We concur with the view expressed in Value AIFRS Holdings example accounts (2006 commentary note 8, page 121) that "AASB 137 does not generally apply to employee benefits as these are dealt with by AASB 119 *Employee Benefits*" and therefore that disclosure of movements in employee benefit provisions is not required.

Note 9 - Movements in provisions - page A78 - (2)

AASB 137.84 requires the following disclosures in relation to movements:

"For each class of provision, an entity shall disclose:

- (a) the carrying amount at the beginning and end of the period;
- (b) additional provisions made in the period, including increases to existing provisions;
- (c) amounts used (that is, incurred and charged against the provision) during the period;
- (d) unused amounts reversed during the period; and
- (e) the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.

Comparative information is not required."

We suggest that the column headings shown do not conform to these requirements.

Note 12 - Commitments - page A87

Reference should be made to the disclosure requirements for leases in AASB 117.31(e) for finance leases and AASB 117.35(d) for operating leases.



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Note 13 - Asset renewals ratio - page A89

The ratio appears to be similar to the *annual renewals deficiency as % of renewals capex* recommended by the *Allen Report*¹, but it has not been clearly defined, so the extent of the similarity cannot be discerned.

Following the SA Inquiry into the Financial Sustainability of Local Government, another similar indicator has been developed for use by SA Councils. Their *asset sustainability ratio* is defined as²:

Capital expenditure on renewal or replacement of existing depreciable assets/depreciation expenses.

Calculated as:

Expenditure on renewal/replacement of assets (Cash Flow Statement)³
Less: Sale of replaced assets (Cash Flow Statement)

divided by:

Depreciation, amortisation & impairment expense (Income Statement)
Expressed as a percentage (no decimal places).

If such an indicator is to be used, then the meaning of *new assets*, as distinct from *asset renewals*, needs to be defined. (It also should be clearly noted that the meaning of *new assets*, in this context, differs from the equivalent definitions for ABS purposes.) The definition needs to address the treatment of enhancements to existing assets on renewal.

We submit that, in the long term, there are benefits in developing common financial indicators across all jurisdictions and that equivalent indicators in other jurisdictions should be considered, all appropriate terms defined, and Council finance staff warned of the need to extract the additional information from assets records, well in advance of its introduction.

We submit that the introduction of this ratio should be deferred for at least 12 months pending a review of equivalent indicators in other States, and early promulgation of definitions.

Note 14 - Investment Properties - page A93

The Note will not be required to be completed by a significant number of Councils and does not form part of a logical sequence (AASB 101.103-107). The contents of the note should be inserted as a sub-heading in Note 9, and as supplementary information in Notes 3 & 4.

Many Councils have non-cancellable operating leases in respect of premises that do not meet the definition of Investment Property, either because the property was acquired for strategic purposes, or because the leased portion is subsidiary to the social service that is the principal reason for retention of the property (see AASB 140.Aus9.1).

However, AASB 117.56 requires disclosures in relation to ALL non-cancellable operating leases. Continued location of these disclosures in the Investment Property note may lead to incorrect interpretation of the requirements in the Standards.

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1. Are Councils Sustainable? Independent Inquiry into the Financial Sustainability of NSW Local Government, p 275.
 2. SA Model Financial Statements 2007, page 101.
 3. The SA requirements include the separate reporting of capital expenditure for new/upgraded assets, and for renewal/replacements of assets, in the Cash Flow Statement.



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The references in the example (Commentary pages A95 & A96) to transition to AIFRS are superfluous.

Note 15 - Financial Instruments - page A98

We suggest that reference should be made to AASB 7.B3 in relation to the significance of financial instruments in the context of each Council's operations, and hence the level of disclosure that is appropriate.

Note 17 - Developer Contributions - page A104

As we understand it, prior to the amendments to the EP&A Act, Councils were permitted to expend general fund monies in advance of contributions, and to recoup those monies to general fund when subsequent contributions were received. As we understand it, that circumstance still applies, and hence there remains a potential requirement for disclosure of amounts expended in advance¹.

Alternatively, if expenditure in advance is to be excluded from the amounts expended - as suggested by paragraph 23 of the commentary on page A107 - we question whether EP&A Regulation 35(c) will be complied with. If it is deemed that it does comply, we suggest that a clear explanation of the basis of compliance - and the treatment to be applied as moneys are recouped to general fund - should form part of the commentary.

Since the amendment to the EP&A Act, Councils can now make an "internal borrowing" from contributions received under one section of a plan to fund expenditures made under another section of the plan, and hence the potential need for an "internal borrowings" column.

From 2008 there will be required disclosures of 3 projections columns - the previous total amounts expended column has been deleted - and we therefore suggest that the need for separate columns for cash and non-cash contributions is still required, or whether a simple reconciliation at the foot of the note would suffice (or, alternatively, amended disclosures in Note 3).

Commentary - Note 19 - page A112

As we understand it, the key difference in the circumstances when "proportional consolidation" rather than equity accounting is required, is that the joint arrangement requires the **unanimous consent** of all parties². We question whether the commentary provides sufficient, and clear, guidance on the accounting technique that is appropriate.

Given the increasing use of strategic alliances, etc. an example of this type should be provided, or at least, the accounting treatment discussed in that context rather than in general terms.

Note 20 - Retained earnings - page A114

Other than the narrative description of the purposes of the revaluation reserves, most of the information in this Note has already been supplied in the Statement of Changes in Equity, and its purpose is difficult to discern.

1. Referred to in footnote (2) to the Note.
2. AASB 131.3 Definitions "joint control"



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We are of the view that any correction of prior period errors, and the consequent disclosures in accordance with AASB 8, should be made in a Note entitled to the effect of *Prior Period Corrections*, rather than as an afterthought on another Note.

Note 21 - Reinstatement etc. Liabilities - page A116

We suggest that the example disclosures do not comply with the requirements of AASB 137.84 (see "Note 9 - Movements in provisions - page A78 - (2)" on page 9 above).

Other than the narration, we have difficulty in identifying the information additional to that which should be shown in Note 10 - and indeed the narration can comfortably be shown in Note 10 as a disclosure in accordance with AASB 137.85.

We have not been able to identify the reference in the standards to "risk-free cost of borrowing". AASB 119.Aus78.1 specifies that market yields on government bonds are to be used discount in relation to employee benefit liabilities, and AASB 137.47 refers to pre-tax rates that reflect current market assessments for of the time value of money and the risks specific to the liability for other provisions.

We submit that it would be more consistent, and convenient for users, to specify that market yields on government bonds be used for all Council discounting purposes.

There are a number of minor issues that, for lack of time, we have not addresses, nor have had the opportunity to review the Special Purpose Reports or the Special Schedules, and for this we apologise. We shall be pleased to supply any further information in support of our submission that you may require.

