LOCAL GOVERNMENT CODE OF ACCOUNTING PRACTICE and FINANCIAL REPORTING

DRAFT UPDATE #19

Submission by

DG & AB MAXWELL
Consulting Accountants

INTRODUCTION

Our firm provides specialist financial and administration consulting services solely to Local Government throughout Australia, but principally within New South Wales. Our senior principal, David Maxwell is a Fellow of the Institute of Chartered Accountants and an Associate of Local Government Managers Australia with over 35 years experience as Local Government Auditor, Principal Accounting Officer, Chief Executive Officer and Consultant.

We have previously provided comments on most updates to the *Local Government Code of Accounting Practice and Financial Reporting* (the Code), and this continues the series. This submission includes items that have appeared in previous submissions. Our aim continues to be the provision of the most convenient, practical and flexible guide for practitioners that can be achieved.

We have used the "Guidelines" version as the basis of our comments.

STATEMENT OF CHANGES IN EQUITY

AASB 101.106 requires:

> (d) for each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing changes resulting from:
>
> (i) profit or loss;
>
> (ii) each item of other comprehensive income; and
>
> (iii) ...

The row "total comprehensive income" should therefore be expanded to comply with the accounting standard.

Both of the major template suppliers complied with AASB 101.106(ii) in 2010. We express our disappointment that the Code proposes to replicate this error in 2011. We find the excuse that this disclosure will be permitted in the notes pursuant to AASB 2010-4 to be unconvincing.

AASB 2010-4 takes effect for accounting periods commencing on and after 1 January 2011, so the disclosure chosen adopts this standard early, and the early adoption should be clearly disclosed in Note 1. However, paragraph 40 on page A-45 specifies that the standard is NOT to be adopted early.

NOTE 1 - CONTRADICTIONS

Jointly Controlled Assets

The accounting policy set out on page A-29 under (c)(iii) directly contradicts the DLG policy determination at paragraph 4a on page A-144.

Borrowing costs

The accounting policy set out on page A-31 under paragraph (iii) of (i) *Inventories* is in direct conflict with that stated at (q) *Borrowing costs* on page A-35.

Investments and other financial assets

The accounting policy in the third paragraph under the sub-heading *Subsequent Measurement* on page A-33 is in direct conflict with the first paragraph under the sub-heading *Investment Policy* on the same page. If Council's investment policy complies with section 625 of the LG Act and clause 212 of the Regulations, there will be NO financial instruments designated in a foreign currency.

LAND UNDER ROADS

"Unit Value"

We have been unable to identify any definition of the term "unit value" used in the first two valuation methods described on page A-96. We submit that this term MUST be defined.

The following comments are made on the assumption that the "unit value" referred to is derived from the valuations supplied to Councils for rating purposes by the Valuer-General.

> The valuations supplied by the Valuer-General for rating purposes are of "land value" as defined in the Valuation of Land Act 1916 and include the value of certain improvements described as "land improvements". "Land improvements" may be shortly described as clearing, drainage and underground drains, and removing stone and excavations and filling for the erection of buildings.
>
> In some areas, these would amount to significant sums.
>
> In any case, the "land value" can be expected to exceed "site value" as defined on page A-97.

Alternative Valuation Methods

Councils are permitted to use any of the three alternative methods for valuing land under roads acquired before 1 July 2008 (page A-97).

Both methods 1 & 2 provide for the use of "unit value" without deduction, and we have shown above that if this is intended to refer to "land value", then this would generally exceed the "site value" referred to in method 3 (the en globo method). However, method 3 then deducts allowances totalling 90% of site value to derive the fair value of the land under roads.

It therefore appears that two of the alternative methods would result in valuations, for any given piece of land, in excess of 10 times the valuation derived using the third method. **We express our concern that this could result in "value shopping" by Councils.**

We note that no guidelines have been provided to assist Councils in determining which of the 3 valuation methods should be adopted in any given set of circumstances.

> We submit that this combination of factors will make it almost impossible for auditors to assess whether the resultant valuations are fair and appropriate for the Council to adopt.

Recognition Issues

AASB 1051 *Land under Roads* authorised - where land under roads acquired prior to 1 July 2008 was being recognised - a journal entry dated 1 July 2008 debiting the asset land under roads and crediting equity.

The draft Code does not provide any guidance on the disclosure to be used where this is now being done in the 2010/2011 reporting period. Is it to be shown as an accounting error? - that the relevant amounts were omitted from the 2009 & 2010 financial reports in error.

Subsequent Additions

The draft Code does not provide any guidance on whether any or all of the 3 valuation methodologies should be adopted by Councils for land acquired for no or nominal consideration subsequent to 1 July 2008 (the recognition cost of which is the fair value at the date of acquisition). Our inspection of Council annual statements as part of the judging process for the Local Government Finance Professionals Annual Statement Award suggests that few Councils have actually been attributing a cost to such land.

NOTE 20 - REVALUATION RESERVES & RETAINED EARNINGS

Retained Earnings

The section (a) should be removed as it duplicates the information required to be disclosed in the *Statement of Changes in Equity.*

Revaluation Reserves

The balance standing in the Asset Revaluation Reserve <u>for each class of asset</u> assumes some importance where impairments and revaluation decrements are firstly offset against the amount in revaluation surplus for the class of asset (see AASB 116 paras. 40, Aus40.1 and Aus 40.2).

This section should therefore separately disclose the movements in asset revaluation reserve for each class of assets.

GENERAL - IRRELEVANCIES

One of the principal purposes of the Code is to specify the format and presentation of the principal statements - Income Statement, Comprehensive Income Statement, Balance Sheet, Statement of Changes in Equity and Statement of Cash Flows.

Accordingly, irrespective of any alternative presentations permitted by AASB 101, any Council annual financial statements that fail to comply with the presentation set out in the Code will be non-complying, and we presume wold be rejected by the Division of Local Government.

> We therefore submit that the bulk of the contents of pages A-14 and A-15 are irrelevant. We suggest that similar critical editing could occur throughout the entire draft. We suggest that relevant key words indicating similar irrelevancies would include *tax, foreign* and *first-time adopters*.

Note 1 Irrelevancies

We draw attention to the following:

1. Page A-29, (c) *Principles of Consolidation, (iv) County Councils*

   This section is NOT an accounting policy - it is an explanation for the reason that the (fictitious) county council has not been recognised. In fact, as well as having neither control nor significant influence, the Council does not have any direct investment in the county council.

   It would be equally (in)appropriate to disclose the reasons for non-consolidation of Council's interest in the Local Government or Shires Associations, or the regional local government organisations.

   Or, for that matter, in the Melbourne Cricket Ground.

If the matter is to referred to in the annual statements at all - the necessity for which we dispute - it should be in Note 18 retitled “Contingencies and Assets and Liabilities not recognised”.

2. Page A-38, (x) *New accounting standards and interpretations*
AASB 108 actually states:
30 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
   (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.
31 In complying with paragraph 30, an entity ***considers disclosing***: [our emphasis]
   (a) the title of the new Australian Accounting Standard;
   (b) the nature of the impending change or changes in accounting policy;
   (c) the date by which application of the Australian Accounting Standard is required;
   (d) the date as at which it plans to apply the Australian Accounting Standard initially; and
   (e) either:
      (i) a discussion of the impact that initial application of the Australian Accounting Standard is expected to have on the entity's financial statements; or
      (ii) if that impact is not known or reasonably estimable, a statement to that effect.

We submit that due ***consideration*** would result in the omission of sub-paragraphs (ii), (iii), (iv) and (vi) on the grounds that they have no relevance to NSW local government.

Similarly we submit that the narrations for pending standards that will have no substantial effect on the numbers reported should be curtailed or omitted, other than a statement to that effect.