Submission to IPART

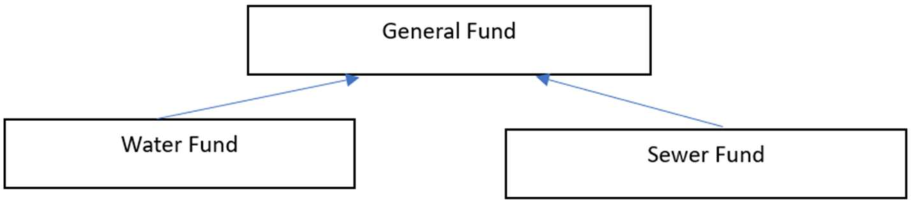
This submission is a broader submission that has implication for the Office of Local Government (OLG) and the NSW Auditor Office. I will be passing this document on to both these organisations. IPART needs to be aware of these issues as it has an impact on funding, more directly Special Rate Variations (SRVs). There is a culture within Local Government (LG) of cash accounting and it appears to have flowed into the Auditors. Part of the funding solution is to get the reporting correct to understand LGs actual financial performance and financial position.

I have focused on NSW Multi Fund Councils (MFCs) and their reporting at a Subsidiary Business level. Most importantly the information MFCs supply for SRV applications. MFCs are not preparing their financial reports or budgets, at the Subsidiary Business level, in accordance with accounting standards and principles. To allow State and Federal Governments to get the funding model right, first they need accurate and reconciled reports to gauge Councils actual financial performance and financial position.

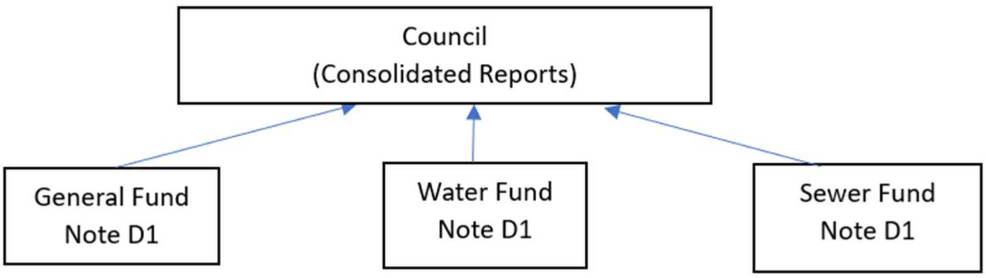
The underlying problem is most NSW MFCs have not matured past cash accounting principles. This submission and attachments will prove this statement. I have discovered 79 (92%) MFCs have used cash accounting principles to prepare their report by fund (Note D). Only one Council of the 7 MFCs who used accrual accounting for their statements, used accrual accounting to prepare their budget.

By applying equity movements test and cash flow movements test to all reports by fund show no NSW MFCs has prepared balanced and accurate reports (Note D in the financial statements) or LTFP/Budgets. These tests are industry standard and it is clear that the Subsidiary Business Note is not looked at too closely by the auditors if they look at it at all.

There is a fundamental lack of understanding by financial professional and LG executives of accrual accounting. Most operate on the misconception that Water Fund (WF) and Sewer Fund (SF) are Subsidiary Business of General Fund (GF). This is evident by the number of MFCs who prepare their LTFP/budgets with WF and SF as line items within GF.



The correct view for MFCs, is that the Council is a reporting entity only, and the funds are Subsidiary Business of Council. Council, at the consolidated level, does not have any assets or liabilities or have any transactions, all assets, liabilities, and transactions are at the Subsidiary Business level. That is, they operate two Subsidiary Business, WF and SF, and one mixed business that contains all other activities of Council, GF.



Following are my recommendations to allow better clearer reporting, which will feed up into a better funding model.

1. **Adjustment to funding model.**
2. **Rename “Funds” to “Subsidiary Business”.**
3. **Audit budgets and LTFP for Councils requesting SRVs.**
4. **Create a formal education module to teach accrual accounting in LG.**
5. **Additional information in “Subsidiary Business” reporting, that is Note D of the annual reports and in the LTFP.**
6. **Introduce a separate set of reports “Subsidiary Business General Purpose Financial Statements”.**
7. **Add a new benchmark “Surplus to Capital additions”.**
8. **Standardised templets for LTFP and Annual Reports.**
9. **Split out more Subsidiary Business, including but not limited to Waste Business, Airports, Childcare Services and Aged Care services.**

1. **Adjustment to funding model.**
    a. A system needs to be introduced to help Councils to maintain pace with inflation. Rate pegging has not kept pace with inflation and the State Government needs to take responsibility for this situation. Where a Councils rates are restricted by NSW Government, the Government should make up the short fall between rate pegging and inflation by a subsidised payment. This will reduce the number of Councils requesting SRVs.

    b. It is clear to most financial professionals in LG that Councils need more operating funding. Too many State and Federal grants are capital types of grants. At the risk of biting the hand that feeds Council, funding needs to be moved from capital to operational and a fixed amount for each Council be allocated each year.

    A quick look at the 86 MFCs reveals that in 2021 FY total grants equalled 94% of rates and annual charges. In 2022 FY the grant funding was 108% of rates & annual charges. Yet the benchmark in the LG Code states own source of income of 60% of Income before Capital income.

    To give Councils the opportunity to plan long term and remove the uncertainty of programs being discontinued, move more of the discretionary grant funding into a FAGs like fixed grant. If Councils knew they were to receive, say 80% of their rates and annual charges as income including the FAGs grant, Councils would have more security and better ability to plan long term.

    By having a set percentage of FAGS, or similar, to rate and charges income also places pressure on the State and Federal Governments to maintain funding in line with inflation. Afterall, grant money is rate payers’ income tax and GST being returned to Councils.

2. **Rename “Funds” to “Subsidiary Business”.**

By renaming the business activities from “Funds” to “Subsidiary Business” of MFCs removes any ambiguity and brings LG into the 21st century and aligns LG with modern business and accounting practices. This change calls the business activities what they are, Subsidiary Business. Some finance professionals within LG fail to recognise and understand this concept. This is evident by the number of Councils who prepare their budgets in one table.

Making this change will reinforce the accrual accounting principles and make old school financial professionals and executives more focused on accrual accounting.

3. **Audit budgets and LTFP for Councils requesting SRVs.**

Audit of budgets and LTFPs is required to ensure all revenue and expenses have been included to allow accurate reporting. I have researched all 128 NSW Councils and found 86 Councils have reported **Subsidiary Business**. My research of the 86 MFCs reveals no Council has reported balanced and reconciled set of **Subsidiary Business** accounts using common industry test. Point four below, has an example of a simple test to confirm the method of accounting used.

SRVs are applied to GF only, therefore good accurate reporting and budgeting is required at the **Subsidiary Business** level to understand if a Council needs an SRV. My research shows only seven councils have attempted to report their **Subsidiary Business** correctly in their annual financial reports, and in accordance with Note D commentary. The other 79 (92%) multi fund **(multi– Subsidiary Business)** Councils have incorrectly reported on a cash basis, that is, not including internal transactions between **Subsidiary Business** in their reports.

The impact of practicing cash accounting is GF is missing revenue. One example is the 2022-23 budget at Snowy Valley Council. I left SVC in March 2023 with the budget 99% complete. My version was prepared on an accrual basis and the GF was, for all intents and purposes, balanced. The published version was prepared on a cash basis and reported a GF $4 million deficit.

I performed further analysis on the seven years of published statements, and I have identified a potential $17 million short fall of income in GF. This potential $17 million short fall is way above the current SRV, indicating no need for a further SRV.

The following table is the SVC’s equity movements reconciliation on GF from public reported information (Note D). It shows a consistent imbalance in the equity reconciliation between $1.4 million and $3.2 million each year.

General Fund	GF Amalgimated	2017 GF Actual	2018 GF Actual	2019 GF Actual	2020 GF Actual	2021 GF Actual	2022 GF Actual	2023 GF Actual
Net Operating Result		10,985	(1,459)	2,670	5,098	5,995	6,977	8,477
Other Comprehensive								
Gain on Revaluation		638	3,418	792	59,546	10,268	63,950	43,843
Total other Comprehensive Income		**11,623**	**1,959**	**3,462**	**64,644**	**16,263**	**70,927**	**52,320**
Accumulated surplus		482,283	480,859	483,564	473,504	479,534	486,543	495,058
Revaluation Reserve		638	4,056	4,759	64,305	74,002	137,185	180,484
		482,921	**484,915**	**488,323**	**537,809**	**553,536**	**623,728**	**675,542**
Equity Reconciliation								
Opening Equity		468,072	479,695	481,654	485,116	534,566	550,829	621,756
Adoption of AASB 15/1058					(15,194)			
Net result for the year		10,985	(1,459)	2,670	5,098	5,995	6,977	8,477
Gain (Loss) on revaluation		638	3,418	792	59,546	10,268	63,950	43,843
	468,072	**479,695**	**481,654**	**485,116**	**534,566**	**550,829**	**621,756**	**674,076**
Variation		3,226	3,261	3,207	3,243	2,707	1,972	1,466

This next table is the SVCs cashflow reconciliation of the GF from public reported information. This example shows GF cash has decreased by $1.534 million, however there is a negative imbalance of $1.466 million. The cash movement cannot be relied on as there is a potential $19 million imbalance in equity movements reconciliation above.

General Fund	2017 GF Actual	2018 GF Actual	2019 GF Actual	2020 GF Actual	2021 GF Actual	2022 GF Actual	2023 GF Actual
Reconciliation of result to Net Cash							
Operating Surplus/(Deficit) for the Year	11,623	1,959	3,462	64,644	16,263	70,927	52,320
Adjustments for non cash items:							
Adoption of AASB 15/1058				(15,194)			
Change in Operating Assets and Liabilities							
Decrease/(Increase) in Receivables	4,543	180	(1,471)	(611)	(4,187)	1,917	149
Decrease/(Increase) in Inventories	219	286	86	52	44	47	(6)
Decrease/(Increase) in Other Assets	165	(124)	121	43	(335)	(165)	(78)
Decrease/(Increase) in Investment Assets	0	72	(340)	0	0	(51)	41
Decrease/(Increase) in Fixed Assets	(153)	(5,729)	(2,987)	(67,566)	(19,017)	(74,204)	(51,730)
Increase/(Decrease) in Payables	(2,414)	215	266	(266)	1,472	1,506	(308)
Increase/(Decrease) in other provisions	541	(755)	690	789	506	168	511
Increase/(Decrease) in Borrowings	(355)	(415)	(451)	(45)	200	(368)	(255)
Increase/(Decrease) in Contract Liability	0	0	429	8,783	(583)	5,075	(3,151)
NET CASH FLOW FROM ALL ACTIVITES	**14,169**	**(4,311)**	**(195)**	**(9,371)**	**(5,637)**	**4,852**	**(2,507)**
Opening Cash	22,990	40,385	36,109	35,860	26,525	20,352	24,469
Closing Cash	40,385	36,109	35,860	26,525	20,352	24,469	21,456
Increase/(Decrease) in Cash	**17,395**	**(4,276)**	**(249)**	**(9,335)**	**(6,173)**	**4,117**	**(3,013)**
Cash Movement to Cash & Cash Equilevent	(3,226)	(35)	54	(36)	536	735	506

The above demonstrates the importance of having GF reports and budgets independently audited before any SRV is granted.

4. **Create a formal education module to teach accrual accounting in LG.**

Subjects covered in this module would include.

- Subsidiary Reporting,
- How to perform a cash flow reconciliation,
- Financial Statements preparation,
- Allocation of Overheads, and
- How the rating system works.

The module could be included in a business degree or at the CPA, CA level.

I have performed an extensive review of NSW Councils 2020-21 and 2021-22 financial Statements and reviewed their budgets. My focus was on the 86 NSW MFCs and found only seven Councils attempted to prepare their financial reports (Note D) on accrual-based accounting. Of this seven, only one prepared their budget/LTFP on an accrual basis. (Please see attached submission sent to the Office of Local Government in March 2024).

The message is that 92% of MFCs have mislead readers of financial statements when reporting Note D. Note D commentary says all internal transaction are included in the report, however only seven Council have included internal transactions in their financial statements and only one of these councils has included internal transactions in their budget/LTFP.

What is “accrual” v “cash” accounting? I call “Cash” accounting the practice of excluding internal transaction between funds or using General Fund as a balancing fund when preparing reports at the fund level. “Accrual” accounting, on the other hand, is the practice of treating each fund as a Subsidiary Business of Council and including transactions between these Subsidiary Businesses.

A simple test can be performed to identify the basis of preparation. You add the total income from Note D in the financial statements and compare the result to the total income in the consolidated income statement. The sum of funds must be greater than the consolidated accounts as transaction between funds are removed in the consolidated report. If the two values equal, then “Cash” accounting was used to prepare the annual statements or LTFP/budgets.

The same test was applied to LTFP/budgets, add the total income by fund and compare to the consolidated report. The 86 MFCs LTFP/budgets show inconsistencies in reporting, however, of the readable ones, the same high percentage have prepared their budgets on a “Cash” basis or have included their WF and SF as a line item in GF budgets.

One example of cash accounting is land owned by WF and SF. Both funds pay rates to GF, but this income and expense is removed in the consolidated statements.

Internal transactions include.

- Rates, Water and Sewer charges,
- Plant hire charges,
- Wage oncosts, and
- Overhead recovery for payroll, HR, Accounts Payable and Accounts Receivable

Evidence that accrual accounting must be used can be found in LG Code of accounting practice (the code) in the commentary in Note D of the financial Statements and Special Purpose Financial Statement, Note D states: *”All amounts disclosed in this note are gross i.e. inclusive of internal charges and recoveries made between the Funds”*. All these businesses sit on the same level and have transactions between each other, however, 92% of MFCs fail to include these internal transactions in Note D.

My experience is that too many financial professionals and executives believe LG is a cash accounting environment and a unique accounting system, a hangover from pre 1996 when accounting standard AAS 27 was introduced. Accounting standards, LG regulations, and legislation all say otherwise. A formal educational program is required to change the thinking of financial professionals and executives that LG is not a cash accounting environment. More than 90% of General Managers and Responsible Financial Officers have signed statements that are incorrect at the Fund (Subsidiary Business) level.

Using the simple test mentioned above, the following two reports contrast the difference between Cash and Accrual accounting. SVC has all zeros in the variation column, indicating no internal transaction have been included and cash accounting has been used.

SVC 2022	GF	WF	SF	Total Subsidiary Business (Funds)	Consolidated	Variation
Rates & annual charges	11,972	1,615	4,413	18,000	18,000	0
User charges & fees	15,224	3,297	786	19,307	19,307	0
Interest & investment revenue	239	33	44	316	316	0
Other Revenues	5,594	38	67	5,699	5,699	0
Grants & contributions - Operating	15,074		11	15,085	15,085	0
Grants & contributions - Capital	13,247	264	238	13,749	13,749	0
Other income	1,397			1,397	1,397	0
Total Income	62,747	5,247	5,559	73,553	73,553	0
Employee Benefits	18,839	921	1,063	20,823	20,823	0
Materials & contracts	24,791	1,699	1,600	28,090	28,090	0
Borrowing costs	106	173	119	398	398	0
Depreciation & amortisation	8,851	16,159	1,508	26,518	26,518	0
Other expenses	614	289	206	1,109	1,109	0
Net loss from disposal of assets	2,569	(5)	18	2,582	2,582	0
Total Expenses	55,770	19,236	4,514	79,520	79,520	0
Net Operating result	**6,977**	**(13,989)**	**1,045**	**(5,967)**	**(5,967)**	**0**

Whereas Clarence Valley Council has offsetting income and expense values in the variation column, indicating internal transaction have been included in the Subsidiary Business and accrual accounting has been used.

Clarence Valley Council 2022	GF	WF	SF	Total Subsidiary Business (Funds)	Consolidated	Variation
Rates & annual charges	48,762	3,039	19,421	71,222	68,736	2,486
User charges & fees	19,865	13,964	2,518	36,347	35,380	967
Interest & investment revenue	815	652	321	1,788	1,788	0
Other Revenues	1,374	2,420	2,332	6,126	1,500	4,626
Grants & contributions - Operating	35,866		380	36,246	36,246	0
Grants & contributions - Capital	30,704	6,687	2,082	39,473	39,473	0
Other income	687			687	687	0
Total Income	138,073	26,762	27,054	191,889	183,810	8,079
Employee Benefits	34,130	1,431	1,492	37,053	37,053	0
Materials & contracts	42,558	5,999	6,316	54,873	46,794	8,079
Borrowing costs	1,315	1,484	3,619	6,418	6,418	0
Depreciation & amortisation	32,932	7,171	8,648	48,751	48,751	0
Other expenses	5,098	3		5,101	5,101	0
Net loss from disposal of assets	12,128	1,285	281	13,694	13,694	0
Total Expenses	128,161	17,373	20,356	165,890	157,811	8,079
Net Operating result	**9,912**	**9,389**	**6,698**	**25,999**	**25,999**	**0**

Further evidence that SVC' budget is incorrect is my version, accrual accounting, of the 2023-24 budget was close to balanced and the published, cash accounting, version had a GF deficit of $4 million. Using the above comparison, Clarance Valley's total income is approximately double that of SVC, the variation between the funds and consolidated is $8 million, 50% of $8 million is $4 million, which happens to be the GF cash budget deficit result, proving GF is missing income.

5. **Additional information in "Subsidiary Business" reporting.**

Adding the following lines in the income statement of **Subsidiary Business** ensures internal transaction are reported and allows clearer reporting.

Internal Rate Income
Internal User Fees & Charges Income
Internal Overheads Recovery
Internal Plant income

Internal Rate Expense
Internal User Fees & Charges Expense
Internal Overheads Charges
Internal Plant Expense

Following is a hypothetical example. Note, the existing lines equal the consolidate value, however the shaded lines clearly display internal amounts where income offset expense by line and in total. Also, this example demonstrates the test in section four above. The sum of funds is $8,079 greater than the consolidated amount.

Sample Council	**GF**	**WF**	**SF**	**Consolidated**	**Variations**
Rates & annual charges	46,276	3,039	19,421	68,736	0
User charges & fees	18,898	13,964	2,518	35,380	0
Interest & investment revenue	815	652	321	1,788	0
Other Revenues	500	500	500	1,500	0
Grants & contributions - Operating	35,866		380	36,246	0
Grants & contributions - Capital	30,704	6,687	2,082	39,473	0
Other income	687			687	0
Net Gain on disposal of assets					0
Internal Rates received	2,486				2,486
Internal User Charges & Fees Received		667	300		967
Internal Overheads Recovery	3,000				3,000
Internal Plant Income	1,626				1,626
Total Income (Note D1-1)	140,858	25,509	25,522	183,810	8,079
					0
Employee Benefits	34,130	1,431	1,492	37,053	0
Materials & contracts	34,479	5,999	6,316	46,794	0
Borrowing costs	1,315	1,484	3,619	6,418	0
Depreciation & amortisation	32,932	7,171	8,648	48,751	0
Other expenses	5,098	3		5,101	0
Net loss from disposal of assets	12,128	1,285	281	13,694	0
Net share of interest in joint venture Equity method					0
Revaluation decrement / impairment of IPP&E					0
internal Rates Expense		1,234	1,252		2,486
Internal User Charges & Fees Expense	600	200	167		967
Internal Overheads Expense		1,500	1500		3,000
Internal Plant Expense		800	826		1,626
Total Expenses (Note D1-1)	120,682	21,107	24,101	157,811	8,079
Total Operating Result	**20,176**	**4,402**	**1,421**	**25,999**	**0**

Expand reporting in Note D to include at minimum.

Note D1-1 Income Statement. (Currently in Note D).

Note D1-2 Statement of Comprehensive Income. *This will account for reclassification of assets owned by each Fund. The sum of the funds can then be tested against the Consolidated Statements.*

Note D1-3 Statement of Financial Position. (Currently in Note D).

Note D1-4 Statement of Changes in Equity.

Note D1-5 Statement of Cash Flows.

Note D1-6 Restricted cash note for each fund. *This note is required as all cash in WF and SF is restricted in the consolidated accounts but not all of these funds are restricted at the Fund level.*

Note D1-7 Asset Note for each Fund. *Including a note that allows full disclosure and reconciliation by each Fund. Reconciled to Comprehensive Income. Add to the bottom of this note the following comment "Renewal assets includes $1,234K of asset replaced due to natural disaster was funded by $1,200K from Insurance or grants".*

Note D1-8 Cashflow reconciliation. *Reporting this reconciliation will focus preparers of financial statements and LTFPs on ensuring the reports are complete and correct.*

This note also requires auditing. Over 90% of MFCs 2021-22 financial statements failed the equity reconciliation and cashflow tests, closer scrutiny is required from auditors. I would encourage a statement in the audit report recognising the Subsidiary Business report (Note) is reconciled and balanced.

6. **Introduce a separate set of reports "Subsidiary Business General Purpose Financial Statements".**

Another option is to remove Note D from the consolidated statements and have Councils prepare a separate set of general purpose statements "**Subsidiary Business General Purpose Financial Statements**" using the above information at minimum. These statements would be Audited in their own right.

Each **Subsidiary Business** financial report would be prepared with original budgets, this year's actuals, and last year's comparison, presenting more informative information. This address and removes the attuite that "it's just a note so it does not matter".

7. **Add a new benchmark "Surplus to Capital additions".**

Councils have a fear of uncertainty around grants. They continually quote "Operating result after Capital Income". I have never understood why you would remove any income from the result, especially when it is inconsistent with accounting standards. I have witnessed this benchmark being misused to justify the application of an SRV when all other indicators say otherwise.

For the "Operating result after Capital Income" to succeed, Councils would have to double its rate income. A look at the 86 MFCs 2022 FY statements, grants were 108% of rates and charges income line. Councils should be quoting "Own source of income" ratio as this benchmark is to encourage Councils to rely less on grants and more on own source of income. The average MFCs Own source of income for 2020-21 and 2021-22 FYs is 77%, well above the recommended 60%.

A more informative indicator would be "Surplus to Capital additions" benchmark. This benchmark would state "on a ten-year average, operating result before comprehensive income, less depreciation, less loss/gain on disposal, and less revaluation decrement / impairment of IPP&E, be greater than capital additions".

Using Snowy Valley Council's seven years of data since amalgamation the report would look like this.

Consolidated		2017 GPFS Actual	2018 GPFS Actual	2019 GPFS Actual	2020 GPFS Actual	2021 GPFS Actual	2022 GPFS Actual	2023 GPFS Actual
Capital Funding								
Net Operating Result		**9,051**	**(2,671)**	**3,209**	**4,031**	**6,760**	**(5,967)**	**14,766**
Add back Depreciation		12,324	10,541	11,603	11,704	11,172	26,518	11,949
Add back Gain Loss on disposal		2,271	1,084	2,541	2,028	2,305	2,582	3,685
Add back Revaluation decrement / impairment of IPP&E		0	4,046	0	0	14,811	0	0
Less Reversal revaluation decrements		0	0	0	0	0	0	4,219
Total Available for Assets Additions		**23,646**	**13,000**	**17,353**	**17,763**	**35,048**	**23,133**	**26,181**
Asset additions		12,435	14,249	15,153	19,674	21,284	23,773	24,634
Yearly Surplus (Deficit)		**11,211**	**(1,249)**	**2,200**	**(1,911)**	**13,764**	**(640)**	**1,547**
Total 7 year Surplus (Deficit)	*24,922*							
Average 7 year Surplus (Deficit)	*3,560*							
Average Net Operating Income	4,168							

This report shows Council is generating enough surplus to cover asset additions by an average of $3.56 million per year.

The above benchmark is based on how listed companies use their surplus. That is surplus after tax is used in one of five ways.

- Pay Dividends,
- Buy back shares,
- Retain for future losses,
- Asset replacement, and
- Business expansion,

As LG does not have shareholders or pay dividends, the surplus is all about asset replacement or expansion, assuming Council continues to operate in the surplus. Therefore, the above benchmark would be more informative and useful when assessing SRV applications.

During a recent SVC Council meeting the mayor quoted the average operating result after capital was a loss of $5 million per year since amalgamation. When, in reality, GF showed an average operating surplus of $5.5 million.

The below shows a total GF surplus to capital additions of $5.2 million or a yearly surplus average of $753K.

General Fund		2017 GF Actual	2018 GF Actual	2019 GF Actual	2020 GF Actual	2021 GF Actual	2022 GF Actual	2023 GF Actual
Capital Funding								
Net Operating Result		**10,985**	**(1,459)**	**2,670**	**5,098**	**5,995**	**6,977**	**8,477**
Add back Depreciation		9,163	8,292	8,885	8,893	8,211	8,851	9,760
Add back Gain Loss on disposal		2,168	1,084	2,541	1,887	2,284	2,569	3,575
Add back Revaluation decrement / impairment of IPP&E		0	4,046	0	0	14,811	0	0
Less Reversal revaluation decrements		0	0	0	0	0	0	0
Total Available for Assets Additions		**22,316**	**11,963**	**14,096**	**15,878**	**31,301**	**18,397**	**21,812**
Asset additions		11,727	14,249	15,153	19,674	21,284	23,773	24,634
Yearly Surplus (Deficit)		**10,589**	**(2,286)**	**(1,057)**	**(3,796)**	**10,017**	**(5,376)**	**(2,822)**
Total 7 year Surplus (Deficit)	*5,269*							
Average 7 year Surplus (Deficit)	*753*							
Average Net Operating Income	5,535							

If this Council was in financial trouble requiring an SRV, then the seven-year surplus would be showing a (deficit). The data in the above report is using cash accounting, accrual accounting would give a better result. The GF has a potential $17 million short fall in revenue and if included would improve GF financial position.

8. **Standardised templets for LTFP and Annual Reports.**

During my research of LG financial statements and LTFP I found several different formats. The use of different formats for LTFP reveals most Council have missing data. Standardised reporting templets gives confidence to ratepayers and Auditors that all information is included. Some Councils include WF and SF in the GF budget and LTFP.

A review of all NSW MFCs' 2023-24 budget/LTFPs show inconsistencies.

a) 26 (30%) Reported in the correct format but on a cash basis,
b) 9 (10%) Reported in the correct format on accrual basis, only one of these reported Note D on accrual basis in their 2021-22 financial statement,
c) 10 (12%) Reported their budget in one table (cash accounting),
d) 5 (6%) Reported their budget by program, and
e) 36 (42%) have published insufficient information.

9. **Split out more Subsidiary Business, including Waste Business, Airports, Child Care Services and Aged Care services.**

Some Councils have additional services as declared business in their SPFS but only report WF and SF in Note D. Note D (or new set of **Subsidiary Business General Purpose Financial Statements)** needs to include all Subsidiary Business of Council, otherwise the GF becomes a balancing account, and its results are distorted. Council's budgets need to be in the same format, that is split out all identified contestable business.

Most Councils provide contestable services such as waste services, airports, childcare services, and aged care services. The same principle should be applied to these services as water and sewer services. By separating these contestable business gives better clarity on the amount of subsidisation occurring and will encourage Council to make these services self-sufficient. Councils can still choose to subsidise some business, but it will be a clear line item in the statements.

By making all contestable Subsidiary Business mandatory, it allows Councils to better manage the finances of Council's core businesses.

I have attached my submission to the Office of Local Government on financial reporting reform for more detail background.

I am available to discuss any information in this submission.

Regards

Robert Brown CPA.

1. Introduction

1.1. I am making this submission to the Office of Local Government (OLG) with the intent of improving the financial reporting of NSW Local Government (LG) and to allow better decision making by Governments and Councils. I am a CPA Accountant and have recently retired from an accounting career spanning 23 years, including NSW Local Government (LG), seven Councils, and not-for-profit organisations (NFP) of one statutory authority and three non-government organisations (NGOs).

1.2. You only have to read the numerous letters to news out lets and various online forums to know rate payers have little to no confidence in the financial management of LG. By implementing my recommended changes LG may gain some confidence from rate payers and provide more transparent reporting.

2. Reason for Submission

2.1. I believe some Councils have requested and obtained Special Rate Variations (SRV) based on misleading financial information. The reasons behind this misleading information are complicated and technical. Further, my analysis of the General-Purpose Financial Statements (GPFS) and Special Purpose Financial Statements (SPFS) reveals no NSW Multi Fund Council has prepared complete, balance and reconciled set of Note D1, result by fund, using the below nine (9) audit tests, and no test was successful across all Multi Fund Councils.

2.2. SRVs are applied to General Fund only and the only publicly available information comes from note D1, Result by Fund, in the GPFS. It appears this note is not audited as my review below shows 92% of Councils have not prepared note D1 in accordance with The Code of Accounting Practice (The Code) as issued by the Office of Local Government.

2.3. This error has been carried over to budgets which also appear not to be audited. The error has two possible components.

- ***2.3.1.*** Using information from the GPFS and not including internal transactions. Country to the commentary in note D1 and Special Purpose Financial Statements (SPFS).
  - ***2.3.1.1.*** Note D1 – *All amounts disclosed in this note are gross i.e. inclusive of internal charges and recoveries made between the Funds*.
  - ***2.3.1.2.*** SPFS – *Amounts shown in the Income Statement shall include internal transactions. Accordingly, there should be no 'netting off' of amounts for internal charges.*
- ***2.3.2.*** Using General Fund (GF) as a balancing Fund when preparing note D1.

2.4. A review of Snowy Valley Council (SVC) reveals the following potential internal transactions are missing from GF for both the GPFS and Council's budgets.

- ***2.4.1.*** Rates Charged to other funds,
- ***2.4.2.*** Plant hire charges,
- ***2.4.3.*** Wage oncosts, and
- ***2.4.4.*** Overhead recovery for payroll, HR, Accounts Payable and Accounts Receivable

2.5. Supporting the above claim is the fact that SVC's cash balance has increased by $12M in the seven years since amalgamation. Why has Council just imposed 35% SRV and is now requesting another SRV when cash is increasing?

2.6. The incorrect preparation of Council's budget has resulted in understatement of income to General Fund and a cross-subsidisation between Funds. As Water and Sewer Funds are meant to be user pay, it appears that General Fund is being over charged, while Water and Sewer Funds under charged. Until Councils prepare reconciled and balanced Note D1 and budgets, rate payers will continue to be over charged when it comes to SRVs.

2.7. In my experience I have witnessed both examples, 2.3.1 and 2.3.2 when Council's budget was prepared by external consultants.

2.8. The question to be answered is "What is the purpose of Note D1 and SPFS"? If the answer is to only appease the competitivity neutrality requirement, then LG has partly succeeded. However, as LG uses information from Note D1 to support SRV applications, then LG has failed miserably.

3. Simplification of Issue

3.1. Given this is a complicated and technical issue, the following hypothetical example is aimed at the average person to allow them to understand the problem and why the reported financial statements for all NSW Multi Fund Councils are incorrect and in need of an overhaul.

3.2. Example Scenario.

3.2.1. A Parent Company has three subsidiary companies, Company A, Company B and Company C. The Parent Company has no income or expense and is only used for consolidated reporting.

3.2.2. All three subsidiary companies incur $3 million expenses and generate $5 million revenue. In simple terms they each report a $2 million profit in their financial statements. This Implies all three companies are profitable as a stand a loan business.

3.2.3. All three subsidiary companies prepare audited general purpose financial statements and pass these to the parent company for preparation of a set of audited consolidate statements.

3.2.4. Now say Company A receives 25% of its revenue from Company B, and 25% of its revenue from Company C, total internal revenue $2.5 million.

3.2.5. The Parent Company removes $2.5 million from both the income and expense, and reports revenue of $12.5 million ($5 million times 3 less $2.5 million) and expenses of $6.5 million ($3 million times 3 less $2.5 million).

3.3. Local Government's version of the above scenario.

3.3.1. In practice, Councils (the Parent Company) prepare consolidated statement (GPFS) using one of two methods or a combination of both.

3.3.1.1. They prepare the GPFS first and then use this data to prepare the subsidiary company financial statements (SPFS), failing to add back internal transactions,

3.3.1.2. Use General Fund as a reconciling account.

3.3.2. Applying the practice at 3.3.1.1, where the internal transactions have been ignored or GF is a reconciling account, to the above scenario, renders Company A operating at a loss.

3.3.3. Using the above example, the comparative statements using both methods would look like this.

Subsidiary Company Statement

Including internals

	Company A	Company B	Company C	Sum of Income
Revenue	$5,000,000	$5,000,000	$5,000,000	**$15,000,000**
Expenses	$3,000,000	$3,000,000	$3,000,000	$9,000,000
profit (Loss)	$2,000,000	$2,000,000	$2,000,000	$6,000,000

Using Consolidated Data
Method 92% of Councils use

	Company A	Company B	Company C	Sum of Income
Revenue	$2,500,000	$5,000,000	$5,000,000	**$12,500,000**
Expenses	$3,000,000	$1,750,000	$1,750,000	$6,500,000
profit (Loss)	-$500,000	$3,250,000	$3,250,000	$6,000,000

Parent Company Statements

	Consolidated Accounts
Revenue	**$12,500,000**
Expenses	$6,500,000
profit (Loss)	$6,000,000

3.4. The above comparison shows:

3.4.1. Using consolidated data, that is internal transactions are removed, Company A is now unprofitable. Using incorrect reporting methods has caused this misleading result. This is 92% of NSW Multi Fund Councils.

3.4.2. Comparing the Parent Company to the subsidiary split using consolidated data, the income and expense lines are same. That is, Parent Company income of $12,500,000 equals the sum of the Subsidiary Companies (LG method) income $12,500,000. Whereas the Subsidiary Companies (accrual method) income is $15,000,000.

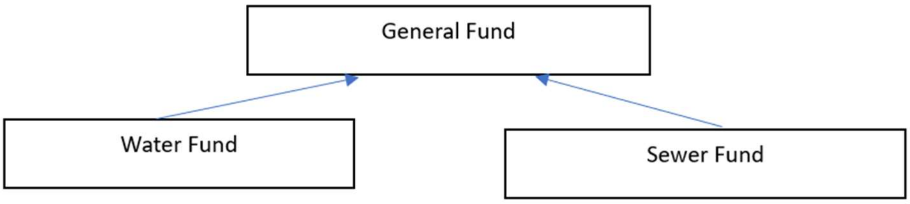
3.4.3. The test explained at 7.1.1 below, of comparing the income line of Funds to the consolidated income is used to identify 92% of Councils have not included all revenue and expense in GF in Note D1.

4. Background

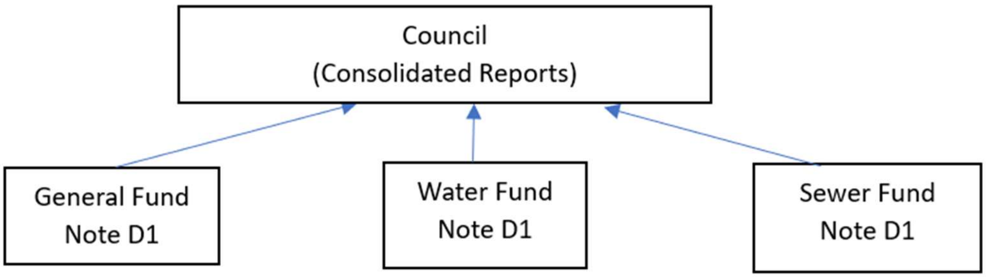
4.1. In 2006 or 2007 I attended one of Graham Bradely's Auswild & Co annual Local Government workshops in Canberra. At this workshop I identified the published financial statements did not report a result for the General Fund where Council has more than one Fund. I recommended a note that summarised result by Fund. The representative from the OLG took that on advisement and said she "would look into it", shortly after I left Local Government employment to work in the NFP NGO space. In 2011 I returned to Local Government to find the financial statements included Note 21, result by Fund. This note, now D1, is an improvement, however my original intent was to treat all funds as Subsidiary Business units and report balance and reconciled set of ***Subsidiary Accounts.*** I believe there is room for improvement to achieve this end.

4.2. I feel part of the problem is how Elected Members and Executives look at Council's structure.

4.2.1. Some view Council's General Fund (GF) as the parent fund and Water Fund (WF) and Sewer Fund (SF) as child funds to GF.



4.2.2. The correct view is Council is the parent Fund (Company) and GF, WF and SF are all child funds on the same level.



4.3. In my experience, the underlying issue is how local government finance professionals and executives treat the financial statements as a statutory requirement (a pain in the ass) and not a tool for decision making, and these individuals also believe Local Government is a ***Cash Accounting*** environment. The contradiction is that Councils, with multiple funds, use the data from cash budgets and cash ***Subsidiary Accounts*** to support special rate variation requests.

4.4. The below case study of Snowy Valleys Council shows the 35% SRV recently granted raised approximately $3 million. Using publicly available data since 2017 and applying an overhead of 15%, there is an understatement of General Fund income of approximately $6.5 million for overhead recovery alone, which is doubled the amount raised by the 35% SRV. When other internal charges such as Rate income and Plant hire charges are considered the missing income from GF increases. Yet this Council believes it needs to apply another SRV. A review of SVC accounts show cash has increased by $12M in seven years and its GF Capital replacement sits at 168% of depreciation, or $42 million more than required by the asset replacement ratio.

4.5. Another error I have witnessed when preparing the budget is not acknowledging capital costs. These are charges like plant hire and overheads where the original costs are recorded in the Operating Statement. If no allowance is made, as was the case at SVC in 2023 LTFP, expense was overstated by $1.6 million.

4.6. LG accounting has evolved, since AAS27 was introduced in 1996, to a quasi-Cash/Accrual accounting environment. That is, trying to be an ***Accrual Accounting*** environment but retaining some characteristics of ***Cash Accounting***. AAS27 essentially meant LG became an ***Accrual Accounting*** environment, however most Councils where I worked struggled with this concept and to accept this change. One example of this resistance is the practice of passing employee's leave taken through the P&L as opposed to accruing and paying leave through the balance sheet as per AASB 119 section 10.

4.7. Further to the introduction of AAS27 is the practices of *I**nterfund Accounting***. *I**nterfund Accounting*** is where a council maintains one bank account for all Council and maintaining a "Fund Ledger". This is a substitution for maintaining a separate set of accounts and a unique account at a bank for each Fund (subsidiary business) and maintaining individual ABNs for each Fund. This accounting method creates confusion when preparing financial reports as some internal transactions need to be retained. These transactions when made by small business as cash out of the bank in one business and revenue or cash received in the other business are mimicked in LG as overheard transactions. Some financial professionals fail to recognise this and focus on cash transactions only.

4.8. I believe there are five possible reasons for poor ***Subsidiary Accounts*** reporting:
- 4.8.1.Incomplete *I**nterfund Accounting*** setup within Council's ledgers.
- 4.8.2.***Cash Accounting*** practice of removing internal transaction between funds when preparing ***Subsidiary Accounts.***
- 4.8.3.Poor preparation of accounts.
- 4.8.4.The practice of using GF as a balancing Fund.
- 4.8.5.Poor accounting knowledge.

Further, the lack of understanding and focus by auditors on Note D1 has allowed this poor-quality reporting to fester.

5. Definitions

5.1. Throughout this submission I will use the following terms.
- 5.1.1.***The Code –*** The Code of Accounting Practice as published by the OLG.
- 5.1.2.***Consolidated Accounts*** – General Purpose Financial Statements for Councils with Multiple Funds.
- 5.1.3.***Subsidiary Accounts*** – All Funds including General Fund and specified Funds reported in SPFS and Note D1.
- 5.1.4.***Cash Accounting*** - The practice of removing all internal transactions. And/or accounting practices that ignore accrual accounting standards.
- 5.1.5.***Accrual Accounting*** - The practice of including internal income and internal expenses in the supplementary reports when required and following accounting standards.
- 5.1.6.***Interfund Accounting*** – Is a method of accounting for multiple business utilising one ledger and one account at a bank. Features of this system are.
  - 5.1.6.1. The organisation's financial ledger has an account component (account level) to identify each subsidiary business.
  - 5.1.6.2. Each Fund (Subsidiary Business) has a unique bank account within the ledger.
  - 5.1.6.3. Transactions between funds trigger movements of equal amounts between these unique ledger bank accounts.

5.1.6.4. If set up correctly a reconciled trial balance report by fund should be possible.

This method allows an organisation to operate under one ABN as contrasted with a parent company with several subsidiary companies that potentially require individual ABNs for the parent company and each subsidiary company.

6. *Process*

6.1. I started by downloading all 128 NSW local Councils' 2022 audited financial statements and I identify 86 Multi Fund Councils.

6.1.1. My following analyses focused on the 86 Multi Fund Councils.

6.1.2. Two (2) multi fund Council's 2022 audited financial statements were not available at that time on their web sites, for comparative and analysis purposes I used their 2021 and 2020 statements.

6.1.3. Three (3) multi fund Council's 2021 Financial Statements were not available so, where possible, I used the comparative data from 2022 Financial Statements. As a result, some audit tests were not possible for these Councils.

6.2. From the GPFS and SPFS I entered values from Income Statement, Statement of Comprehensive Income, Statement of Financial Position, Infrastructure Note, and Statement of Changes in Equity into a spreadsheet.

6.3. Using data from the infrastructure, property, plant and equipment note, C1-6, comprehensive income was split based on revaluation adjustment for Water and Sewer class assets.

6.4. After adjustments made from 6.3 above, further analysis of ***Equity Reconciliation test (7.3)*** and ***Cash Flow Reconciliation (7.4)*** is performed and if necessary, a second adjustment of Comprehensive Income in carry out. This exercise also adjusted, and in some cases reconciled, the ***Cash Flow Reconciliation*** at the Fund level. This process is based on the assumption that Water and Sewer Funds own assets in other asset classes.

6.5. Access to Councils data would be required to confirm the above assumptions.

6.6. From there I was able to perform Audit tests at 7.1 to 7.9.

7. Audit tests applied and explained.

Audit tests used on each set of financial statements to test accuracy and explanation of each test,

7.1. Cash V Accrual Income test – This test confirms if a Council has used the ***Cash Accounting*** method to prepare Note D1 and Budgets. To perform this test, you add total income from each Fund in note D1-1 and compare this to the total Income in the ***Consolidated Accounts*** Income Statement. If the values equal, then the ***Cash Accounting*** method has been used, that is internal transactions between Funds have not been included in the ***Subsidiary Accounts*** and figures from the ***Consolidated Accounts*** were used. When the sum of the Funds Total Income is greater than zero (0), indicates ***Accrual Accounting*** and test 7.2.1 is then applied to confirm ***Accrual Accounting*** has been used. Further access to data would be required to confirm if all internal transactions have been included***.*** A negative value would indicate incorrect or corrupt data.

The ***Cash V Accrual Income test*** is supported by the following commentaries in note D1 and SPFS.

7.1.1. Note D1 – *All amounts disclosed in this note are gross i.e. inclusive of internal charges and recoveries made between the Funds*.

7.1.2. Special Purpose Financial Statements – *Amounts shown in the Income Statement shall include internal transactions. Accordingly, there should be no 'netting off' of amounts for internal charges.*

7.2. Income & expense line variation -When a Council has used the ***Accrual Accounting*** method as per test 7.1 above, income line variation test is used to compare the sum of each Fund line item to the corresponding consolidated statements line item to confirm ***Accrual Accounting*** has been used and not an error from one of the following audit tests.

7.2.1. Total income and expense offset test – if the income imbalance from 7.2 offsets the expense imbalance from 7.2. confirms ***Accrual Accounting*** has been used.

7.2.2. The sum of income variations at the Fund level must equal the sum of expense variations at the Fund level as per the below example.

	Income Statements	Sum of Note D1	Variation
Rates & annual charges	$68,736	$71,222	$2,486
User charges & fees	$35,380	$36,347	$967
Other Revenues	$1,788	$6,414	$4,626
Grants & contributions - Operating	$1,500	$1,500	$0
Grants & contributions - Capital	$36,246	$36,246	$0
Interest & investment revenue	$39,473	$39,473	$0
Other income	$687	$687	$0
Net Gain on disposal of assets			$0
Total Income Variation	**$183,810**	**$191,889**	**$8,079**
Employee Benefits	$37,053	$37,053	$0
Materials & contracts	$46,794	$54,873	$8,079
Borrowing costs	$6,418	$6,418	$0
Depreciation & amortisation	$48,751	$48,751	$0
Other expenses	$5,101	$5,101	$0
Net loss from disposal of assets	$13,694	$13,694	$0
Net share of interest in joint venture Equity method			$0
Revaluation decrement / impairment of IPP&E			$0
Total Expense Variation	**$157,811**	**$165,890**	**$8,079**
Net Variation			**$0**

7.3. *Equity Movements Reconciliation* – Is comparing the operating result plus prior year closing equity to current closing equity for both the Consolidated Accounts and Subsidiary Accounts. For the statements to be reconciled and balanced the prior year equity and current comprehensive income must match current year equity.

Closing prior year Equity	$1,100,000
Current Year Comprehensive Income	$100,000
Total	***$1,200,000***
Current Year Closing Equity	***$1,200,000***

7.3.1. *Equity Cross-subsidisation Test –* This tests for any imbalance at the Fund level nets off between Funds. Any netting off is adjusted at the Comprehensive income line (as per 6.4 above). If there is a value remaining after offsetting the Funds means incorrect or corrupt data.

7.4. *Cash flow reconciliation* – Is the process of confirming all income and expenses are included in the Income Statement. For the statements to be without error, the total comprehensive income plus the movement in each balance sheet account must equal the movement in cash. The following format is an example of a cash flow reconciliation. Note: the increase in cash equals the net cash flow for the reporting period.

Reconciliation of Cash Flows	
Total Comprehensive income	$100,000
Change in Assets and Liabilities (other than cash)	
Decrease/(Increase) in Receivables	$20,000
Decrease/(Increase) in Inventories	($10,000)
Decrease/(Increase) in Other Assets	$45,000
Decrease/(Increase) in Investment Assets	-
Decrease/(Increase) in Intangible Assets	-
Decrease/(Increase) in Fixed Assets	$150,000
Increase/(Decrease) in Payables	$10,000
Increase/(Decrease) in other provisions	$20,000
Increase/(Decrease) in Borrowings	($15,000
Increase/(Decrease) in Lease Liability	($20,000)
Increase/(Decrease) in Contract Liability	-
Net Cash Flow from all Activities	***$300,000***
Movement in Cash	
Closing Cash and Investments	$550,000
Opening Cash and Investments	$250,000
Increase/(Decrease) in Cash	***$300,000***

7.4.1. *Cash flow Cross Subsidisation -* Tests if there is any imbalance at the Fund level. If there is, it means incorrect or corrupt data.

7.5. *Equity to Cash Flow Fund Test* – This test is applied to Councils who fail the "*Equity movements reconciliation (7.3)"* and "*Cash flow reconciliation (7.4)"* in note D1. This test checks if the sum of the Funds Equity (7.3) out-of-balance, equals the sum of the Funds Cash Flow (7.4) out of balance. If the sum of the out-of-balance amounts equal zero (0), indicates Note D1 reconciles at a Fund level, but are missing possible internal income and expense and indicates ***Cash Accounting*** has been used. If the "*Equity to Cash Flow Fund Test"* fails, that is, the value of the sum of Funds does not equal zero (0), indicates incorrect preparation of Note D1.

7.6. Cash V Accrual Balance Sheet Test – If there are no arrangements such as internal loans, the sum of the Funds Total Assets should equal the Total Assets line in the Statement of Financial position in the ***Consolidated Accounts***, likewise with Total Liabilities. If values exist after applying this test, then the test at 7.7 is applied.

7.7. Balance Sheet Internal Loan Test – This test is only applied to Councils who have internal loans or fail 7.6 test. The imbalance of the assets must equal the imbalance of liabilities. An example is an internal loan that appears as an asset in one Fund and a liability in another Fund, however these loans are removed in the ***Consolidated Accounts.*** If the values do not offset, the data is incorrect or corrupt.

7.8. Reconciliation between Note D1 and SPFS. – This test compares Total Assets, Total Liability, Total Expense and Total Income between Note D1 and SPFS. Competitive neutrality data is removed for this test.

7.9. Prior year equity to Current year equity – Tests that the reported values are the same in prior years report and the comparative data in the current years report.

8. Summary of Analysis

Seven (7) Councils have applied ***Accrual Accounting*** to Note D1 as per ***Cash V Accrual Income test 7.1*** and ***Income & expense line variation test 7.2.*** A very low 8% of multi fund Councils. However, no Council passed all tests.

8.1. Following is an analysis of these seven Councils. The below information is based on public available information and some assumptions have been applied to other comprehensive income. All Councils have been treated the same in this exercise, as a result, any variation is reported in the general fund which may not be the case.

Accrual	**Byron Shire Council**
Accrual	**Clarence Valley Council**
Accrual	**Nambucca Valley Council**
Accrual	**Narrabri Shire Council**
Accrual Error	**Shoalhaven City Council**
Accrual Error	**Tamworth Regional Council**
Accrual	**Tweed Shire Council**

8.1.1. Byron Shire Council.

8.1.1.1. Failed GF ***Equity Movements Reconciliation*** tests 7.3 by $5.191M

8.1.1.2. Failed GF ***Cash Flow Reconciliation*** test 7.4 by $22.323M

8.1.1.3. Failed SF liabilities ***Reconciliation between Note D1 and SPFS*** test 7.8 by $35.809M.

8.1.1.4. Failed WF ***Prior year equity to Current year equity*** test 7.9 by $2.515M.

8.1.1.5. Failed SF ***Prior year equity to Current year equity*** test 7.9 by $2.763M.

8.1.2. Clarence Valley Council.

8.1.2.1. Failed GF ***Equity Movements Reconciliation*** tests 7.3 by $5.529M

8.1.2.2. Failed GF ***Cash Flow Reconciliation*** test 7.4 by $22.389M.

8.1.2.3. Failed SF ***Cash Flow Reconciliation*** test 7.4 by $10K.

8.1.3. Nambucca Valley Council.

8.1.3.1. Failed GF ***Equity Movements Reconciliation*** tests 7.3 by negative $2.561M

8.1.3.2. Failed GF ***Cash Flow Reconciliation*** test 7.4 by $6.326M.

8.1.3.3. Failed WF ***Cash Flow Reconciliation*** test 7.4 by $300K.

8.1.3.4. Failed SF ***Reconciliation between Note D1 and SPFS*** test 7.8 by $35.809M.

8.1.3.5. Nambucca Valley appears to have an internal loan of $191K, that is total assets imbalance offsets total liability imbalance by $191K. However, there is no values in borrowing costs or interest income.

8.1.4. Narrabri Shire Council.

8.1.4.1. Failed the GF ***Equity Movements Reconciliation*** tests 7.3 by $485K.

8.1.4.2. Failed the GF ***Cash Flow Reconciliation*** test 7.4 by $485K, however these values offset each other.

8.1.4.3. Failed SF income ***Reconciliation between Note D1 and SPFS*** test 7.8 by $100K.

8.1.5. Shoalhaven City Council.

8.1.5.1. Failed the GF ***Equity Movements Reconciliation*** tests 7.3 by $41.601M.

8.1.5.2. Failed the GF ***Cash Flow Reconciliation*** test 7.4 by $82.091M.

8.1.5.3. Fail the ***Total income and expense offset*** 7.2.1 test by $1.977M.

8.1.5.4. It is noted that Shoalhaven have restated their accounts over the last two years. The 2022 FY restatement equals an equity variation of $102.062M.

8.1.6. Tamworth Regional Council.

8.1.6.1. Failed the GF ***Cash Flow Reconciliation*** test 7.4 by $13.836M.

8.1.6.2. Tamworth appears to have an internal loan, test 7.7 of $14.4M, that is total assets imbalance offsets total liability imbalance by $14.4M, however, there is a variation in Borrowing costs of $160K, Interest & investment revenue $76K and other revenue $160K, this does not appear to be correct. You would expect interest income to offset borrowing costs for internal transaction purposes.

8.1.7. Tweed Shire Council.

8.1.7.1. Failed GF ***Equity Movements Reconciliation*** tests 7.3 by negative $10M.

8.1.7.2. Failed GF ***Cash Flow Reconciliation*** test 7.4 by $278.844M.

8.1.7.3. Failed WF ***Cash Flow Reconciliation*** test 7.4 failed by $10M.

9. *Results of remaining seventy-nine (79) Councils*

9.1. Thirteen (13) Councils.

Balranald Shire Council
Berrigan Shire Council
Bogan Shire Council
Bourke Shire Council
Brewarrina Shire Council
Carrathool Shire Council
Coolaman Shire Council
Gilgandra Shire Council
Hay Shire Council
Junee Shire Council
Lismore City Council
Weddin Shire Council
Yass Valley Council

9.1.1. Failed ***Cash Accounting*** test 7.1 but passed all other tests.

9.2. Five (5) Councils.

Cowra Shire Council
Moree Plains Council
Murrumbidgee Council
Tenterfield Shire Council
Wingecarribee Shire Council

9.2.1. Failed ***Cash Accounting*** test 7.1.

9.2.2. Failed ***Reconciliation between Note D1 and SPFS*** test 7.8, failing one or two subcategories.

9.3. Four (4) Councils.

Cabonne Council
Leeton Shire Council
Lockhart Shire Council
Queanbeyan-Palerang Regional

9.3.1. Failed ***Cash Accounting*** test 7.1.

9.3.2. Failed GF ***Cash Flow Reconciliation*** test 7.4.

9.4. Five (5) Councils

Bathurst Shire Council
Dubbo Shire Council
Glen Innes Severn Council
Mid-Coast Council
Snowy Valleys Council

9.4.1. Failed ***Cash Accounting*** test 7.1.

9.4.2. Failed GF ***Cash Flow Reconciliation*** test 7.4.
9.4.3. These Councils have offsetting values in SPFS for tax equilevent amounts.

9.5. Six (6) Councils

Ballina Shire Council
Lithgow Council, City of
Murray River Council.
Parkes Shire Council
Wagga Wagga City Council
Walgett Shire Council

9.5.1. Failed ***Cash Accounting*** test 7.1.
9.5.2. Failed GF ***Cash Flow Reconciliation*** test 7.4
9.5.3. Failed ***Reconciliation between Note D1 and SPFS*** test 7.8, failing one or two subcategories.

9.6. Three (3) Councils.

Bega Valley Shire Council
Cobar Shire Council
Mid-Western Regional Council

9.6.1. Failed ***Cash Accounting*** test 7.1.
9.6.2. Failed GF and/or SF ***Cash Flow Reconciliation*** test 7.4.
9.6.3. Failed ***Reconciliation between Note D1 and SPFS*** test 7.8, failing one or two subcategories.

9.7. Three (3) Councils

Eurobodalla Shire Council
Lachlan Shire Council
Muswellbrook Shire Council

9.7.1. Failed ***Cash Accounting*** test 7.1.
9.7.2. Failed GF or SF ***Cash Flow Reconciliation*** test 7.4.
9.7.3. One Council failed ***Reconciliation between Note D1 and SPFS*** test 7.8, failing four subcategories,

9.8. Twenty-two (22) Councils.

Armidale Regional Council
Bellingen Shire Council
Bland Shire Council
Blayney Shire Council
Central Darling Shire Council
Coonamble Shire Council
Cootamundra-Gundagai
Forbes Shire Council
Greater Hume Shire Council
Gunnedah Shire Council
Gwydir Shire Council
Hawkesbury City Council
Kyogle Council
Liverpool Plains Shire Council
Narromine Shire Council
Oberon Council
Richmond Valley Council
Upper Hunter Shire Council
Uralla Shire Council
Walcha Council
Wentworth Shire Council
Inverell Shire Council

9.8.1. Failed ***Cash Accounting*** test 7.1.
9.8.2. Failed GF ***Equity Movements Reconciliation*** test 7.3.
9.8.3. Failed GF ***Cash Flow Reconciliation*** test 7.4.
9.8.4. Failed ***Reconciliation between Note D1 and SPFS*** test 7.8, failing one or two subcategories.

9.9. Two (2) Councils.

Orange City Council
Port Macquarie-Hastings

9.9.1. Failed GPFS ***Equity Movements Reconciliation*** test 7.3.
9.9.2. Failed GPFS ***Cash Flow Reconciliation*** test 7.4.
9.9.3. Failed ***Cash Accounting*** test 7.1.
9.9.4. Failed GF ***Equity Movements Reconciliation*** test 7.3.
9.9.5. Failed GF ***Cash Flow Reconciliation*** test 7.4.
9.9.6. Failed ***Reconciliation between Note D1 and SPFS*** test 7.8, failing one or two subcategories.

9.10. Sixteen (16) Councils

Albury City Council
Central Coast Council
Coffs Harbour City Council
Edward River Council
Federation Council
Goulburn Mulwaree Council
Griffith City Council
Hilltops Council
Kempsey Shire Council
Narrandera Shire Council
Singleton Council
Snowy Monaro Regional
Temora Shire Council
Upper Lachlan Shire Council
Warren Shire Council
Warrumbungle Shire Council

9.10.1. Failed ***Cash Accounting*** test 7.1.
9.10.2. Failed ***Income & expense line variation*** test 7.2
9.10.3. Failed GF ***Equity Movements Reconciliation*** test 7.3.
9.10.4. Failed GF ***Cash Flow Reconciliation*** test 7.4.
9.10.5. Failed ***Reconciliation between Note D1 and SPFS*** test 7.8, failing one or two subcategories.

10. Conclusion

10.1. After reading this submission I believe you will agree more needs to be done to improve reporting.

10.1.1. Expand Note D1 to report all funds in a balanced and reconciled manner. The proposed new method will give an accurate and true result that can be used to support SRV applications.
10.1.2. Note D1 needs to be audited,
10.1.3. Councils requesting SRVs need to have their budgets audited.

10.2. I note that, In ***The Code*** you have used the cash accounting approach, that is the sum of the Funds in note D1 equals the income statement in the consolidated accounts. This may have been misleading to the majority of responsible accounting officers given 92% of Councils have followed your example in preparing Note D1. I feel if you update ***The Code*** to reflect accrual accounting, that is make the sum of income and the sum of expense in Note D1 higher than the Consolidated Statements, will give better guidance to LG financial professionals. See 7.2.2 for an example.

11. Recommendations

11.1. Review the I***nterfund Accounting*** setup at each Council to ensure it is working correctly,

11.2. Redesign Note D1 to be a condensed version of General Purpose Financial Statement that include all Funds and can be fully audited and reconciled, and include, at a minimum the following reports.

11.2.1. Note D1-1 Income Statement. This needs to include all transactions between Funds to mimic transactions between Subsidiary Companies.

11.2.1.1. Expand the lines to include internal income and expense items to remove any confusion. Restating example at 7.2.2 above, Note D1.1 would like this.

Sample Council	GF	WF	SF	Consolidated	Variations
Rates & annual charges	46,276	3,039	19421	68,736	0
User charges & fees	18,898	13,964	2518	35,380	0
Interest & investment revenue	815	652	321	1,788	0
Other Revenues	500	500	500	1,500	0
Grants & contributions - Operating	35,866		380	36,246	0
Grants & contributions - Capital	30,704	6,687	2082	39,473	0
Other income	687			687	0
Net Gain on disposal of assets					0
internal Rates	2,486				2,486
Internal User Charges & Fees		667	300		967
Internal Overheads	3,000				3,000
Internal Plant	1,626				1,626
Total Income (Note D1-1)	140,858	25,509	25,522	183,810	8,079
					0
Employee Benefits	34,130	1,431	1492	37053	0
Materials & contracts	34,479	5,999	6316	46794	0
Borrowing costs	1,315	1,484	3619	6418	0
Depreciation & amortisation	32,932	7,171	8648	48751	0
Other expenses	5,098	3		5101	0
Net loss from disposal of assets	12,128	1,285	281	13694	0
Net share of interest in joint venture Equity method					0
Revaluation decrement / impairment of IPP&E					0
internal Rates		1,234	1,252		2,486
Internal User Charges & Fees	600	200	167		967
Internal Overheads		1,500	1500		3,000
Internal Plant		800	826		1,626
Total Expenses (Note D1-1)	120,682	21,107	24,101	157,811	8,079

11.2.1.2. Remove the After Capital result line as this is misleading and of no value. This line implies:

- ***11.2.1.2.1.*** Council should have a nil or positive value after Capital income.
- ***11.2.1.2.2.*** Reality is that if Council has a nil or positive value here it has surplus unallocated cash.
- ***11.2.1.2.3.*** This line also implies assets are being replaced at the same rate of depreciation**.**
- ***11.2.1.2.4.*** Capital Grants fund new assets only.

11.2.2. Note D1-2 Statement of Comprehensive Income. This will account for reclassification of assets owned by each Fund. The sum of the funds can then be tested against the Consolidated Statements.

11.2.3. Note D1-3 Statement of Financial Position

11.2.4. Note D1-4 Statement of Changes in Equity.

11.2.5. Note D1-5 Statement of Cash Flows in SPFS.

11.2.6. Note D1-6 Restricted cash note for each fund.

11.2.7. Note D1-7 Asset Note for each Fund. Including this note allows full disclosure and reconciliation by each Fund. Reconciled to Comprehensive Income. Add to the bottom of the note the following comment “Renewal assets includes $1,234K of asset replaced due to natural disaster and funded by Insurance or grants”.

11.2.8. Note D1-8 Cash flow reconciliation. By adding the cash flow reconciliation (7.4) gives the general public confidence the statements are correct.

11.2.9. Restated operating result and ten year average asset replacement

11.3. Conduct training sessions for elected members, executives and finance professionals to explain the above and the need for balanced and reconciled Note D1.

11.4. Update The Code, Note D1, to include.

11.4.1. *"All amounts disclosed in this note are gross i.e. inclusive of internal charges and recoveries made between the Funds. This includes but not limited to Rates, Fees and Charges, Plant charges, Wage oncosts and Overhead charges for HR, payroll, accounts payable, accounts receivable and other administration services."*

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12. *Case Study Snowy Valley Council*

12.1. I worked at Snowy Valley Council (SVC) between 2020 and 2023. The Council's financial system needed improvement since amalgamation. On my second day at Council, I received an email from my supervisor with a project plan attached. The reason for this project plan was to improve financial reporting and quoted both the internal and external auditors requesting better reporting. The underlying problem was poor system set up and lack of experienced staff to implement change. Unfortunately, in my view, due to lack of understanding from senior staff this project improvement failed at that time. However, some minor changes were implemented during my time at Council.

12.2. Supporting the above "Cash" v "Accrual" approach is my experience in preparing the 2022-23 budget at SVC. Council's budget system stopped working that year and I created an excel model to complete the budget, however due to time constraints Council employed a consultant to complete the Long Term Financial Plan (LTFP). When Council received the LTFP it was different to my version of the budget. I was told to adjust my version to match the LTFP version. During this reconciliation process I discovered three points of difference.

- ***12.2.1.*** The rating income for Council owned property had not been removed, overstating income by some $716K.
- ***12.2.2.*** No allowance for Capital expense, overstating Materials and Services by some $1.6M.
- ***12.2.3.*** The Funds were prepared on a cash basis. That is all internal transaction were removed and the sum of the fund's income equalled the consolidated income.

12.3. Points 12.2.1 &12.2.2 above resulted in a QBR1 budget adjustment of $917k. The preparation of SVC's LTFP is an example of applying "Cash Accounting" principles. The preparation of the LTFP on a cash basis with major errors by a reputable consulting firm highlights the need for high level training. The above error was reported in the September 2022 quarterly report.

Snowy Valleys Council

Income & Expenses Budget Review Statement

Budget review for the quarter ended 30 September 2022
Income & Expenses - Council Consolidated

($000's)	Original Budget 2022/23	Internal Movements Budget 2022/23	Adjusted Budget 2022/23	Revised Budget 2022/23	Variations for this Sep Qtr	Notes	Projected Year End Result	Actual YTD figures
Income								
Rates, Levies & Annual Charges	20,768	(715)	20,053	20,053	-		20,053	20,180
User charges and fees	15,141	-	15,141	15,141	-		15,141	4,075
Interest & Investment Revenue	330	-	330	330	200	51	530	173
Other Income	934	-	934	934	201	15,17,18,21	1,135	567
Grants & Contributions - Operating	10,800	-	10,800	10,800	4,732	7,11,23,24,25 28,29,30,32 34,39,46,49	15,532	4,040
Grants & Contributions - Capital	28,809	-	28,809	28,809	787	8,9,10,12,13 22,26,27,31 33,35,36,37 38,40,41,42 43,44,45,47	29,596	5,912
Proceeds from the sale of assets			-	-	460		460	519
Specific Purpose Contributions	**76,782**	**(715)**	**76,067**	**76,067**	**6,380**		**82,447**	**35,466**
Expenses								
Employee Costs	17,244	1,867	19,111	19,111	541	1,2,5	19,652	3,673
Less Capital Wages		(1,866)	(1,866)	(1,866)			(1,866)	
Materials & Services	14,808	4,261	19,069	19,069	6,008	4,6,11,14 16,19,20,21 23,24,25,28 29,30,32,34 39,46,49	25,077	6,875
Less Capital Plant		(1,694)	(1,694)	(1,694)			(1,694)	
Interest & Investment Losses	344	-	344	344	-		344	109
Depreciation & Amortization	10,984	-	10,984	10,984	-		10,984	2,750
Other Expenses	5,789	(4,262)	1,527	1,527	-		1,527	507
Cost of Assets Sold				-	-		-	-
Total Expenses from Continuing Operations	**49,169**	**(1,694)**	**47,475**	47,475	**6,549**		**54,024**	**13,914**
Net Operating Result from Continuing Operations	**27,613**	**979**	**28,592**	28,592	**(169)**		**28,423**	**21,552**
Discontinued Operations - Surplus/(Deficit)				-			-	
Net Operating Result from All Operations	**27,613**	**979**	**28,592**	28,592	**(169)**		**28,423**	**21,552**
Net Operating Result before Capital Items - Surplus/(Deficit)	**(1,196)**	**979**	**(217)**	(217)	**(956)**		**(1,173)**	**15,640**

This report has been prepared under accounting standards principles on a consolidated basis which includes Capital income and excludes internal transactions.

Note: Internal Movements Variation	
Add Expense for internal costs to Capital not originally recognised	1,694
Less Internal Rates not excluded in original report	(715)
	979

12.4. I left Council in March 2023 when my position became untenable and with the 2023-24 budget 99% complete. GF was close to being a balanced budget. I was surprised to hear Council's Mayor, on local media, announce a $4 million General Fund budget deficit for 2023-24 financial year. This was way over the balanced budget I had prepared so I downloaded the published budget and noticed it was presented in the "Cash Accounting" format as in previous years and not the "Accrual Accounting" format I had prepared. I believe the "Cash Accounting" version has again overstated general fund deficit by a significant amount.

12.5. I then performed an analysis of Council's six years' financial statements and budgets. I found all six years result by fund and budget have been prepared and reported on a "Cash Accounting" basis.

12.6. Council's consolidated financial statements reconcile as per equity test (7.3) and cash flow test (7.4).

12.6.1. At the consolidated level all years reconcile for the equity test (7.3).

Consolidated	GPFS Amalgimated	2017 GPFS Actual	2018 GPFS Actual	2019 GPFS Actual	2020 GPFS Actual	2021 GPFS Actual	2022 GPFS Actual	2023 GPFS Actual
Accumulated surplus		603,949	601,278	604,487	593,324	600,084	594,117	608,883
Revaluation Reserve		1,757	7,278	10,196	70,791	81,783	141,127	188,183
		605,706	608,556	614,683	664,115	681,867	735,244	797,066
Assets								
Additions Renewal		9,191	11,736	13,173	11,296	18,347	22,308	21,266
Additions New		3,324	2,513	2,060	8,648	3,025	1,465	3,376
		12,515	14,249	15,233	19,944	21,372	23,773	24,642
Opening Equity		594,898	605,706	608,556	614,683	664,115	681,867	735,244
Adoption of AASB 15/1058		0			(15,194)			
Net result for the year		9,051	(2,671)	3,209	4,031	6,760	(5,967)	14,766
Gain (Loss) on revaluation		1,757	5,521	2,918	60,595	10,992	59,344	47,056
	594,898	605,706	608,556	614,683	664,115	681,867	735,244	797,066
Variation	0	0	0	0	0	0	0	0

12.6.2. At the consolidated level all years reconcile for the cash flow test (7.4).

Consolidated	GPFS Amalgimated	2017 GPFS Actual	2018 GPFS Actual	2019 GPFS Actual	2020 GPFS Actual	2021 GPFS Actual	2022 GPFS Actual	2023 GPFS Actual
Reconciliation of result to Net Cash								
Operating Surplus/(Deficit) for the Year		10,808	2,850	6,127	64,626	17,752	53,377	61,822
Adjustments for non cash items:								
Adoption of AASB 15/1058					(15,194)			
Change in Operating Assets and Liabilities								
Decrease/(Increase) in Receivat	3,572	6,592	284	(1,366)	698	(4,161)	1,679	(154)
Decrease/(Increase) in Inventor	728	219	286	86	52	44	47	(6)
Decrease/(Increase) in Other As	(373)	165	(124)	121	43	(335)	(165)	(78)
Decrease/(Increase) in Investme	(278)	0	72	(340)	0	0	(51)	41
Decrease/(Increase) in Fixed As	#######	3,548	(3,301)	(3,031)	(66,162)	(17,872)	(53,264)	(58,749)
Increase/(Decrease) in Payable:	486	(2,510)	190	261	(228)	1,495	1,596	(318)
Increase/(Decrease) in other pr	2,486	541	(755)	690	789	506	206	509
Increase/(Decrease) in Borrowi	(7,789)	(1,254)	(1,189)	(1,261)	(903)	(686)	(1,316)	(1,180)
Increase/(Decrease) in Contract Liability	10,632	0	0	429	8,783	(583)	5,208	(3,205)
NET CASH FLOW FROM ALL ACTIVITES		**18,109**	**(1,687)**	**1,716**	**(7,496)**	**(3,840)**	**7,317**	**(1,318)**
Opening Cash		31,215	49,324	47,637	49,353	41,857	38,017	45,334
Closing Cash	31,215	49,324	47,637	49,353	41,857	38,017	45,334	44,016
Increase/(Decrease) in Cash	**31,215**	**18,109**	**(1,687)**	**1,716**	**(7,496)**	**(3,840)**	**7,317**	**(1,318)**
Cash Movement to Cash & Cash Equile		0	0	0	0	0	0	0

12.7. The 2017 FY statements did not include opening balances by Fund.

12.7.1. I was able to reconstruct the cash and investment lines by fund using data from the notes.

12.7.2. The remaining balance sheet accounts were apportioned based on 2018 FY data.

12.8. My analysis of SVC General Fund six years of financial statements follows.

12.8.1. The Equity Reconciliation show a total imbalance of $10,906 million; this is a potential understatement of income to the General Fund. A cash flow reconciliation was performed on all years as per following table.

General Fund	2016 GF Amalgimated	2017 GF Actual	2018 GF Actual	2019 GF Actual	2020 GF Actual	2021 GF Actual	2022 GF Actual
Equity Reconciliation							
Opening Equity		467,434	480,814	482,773	486,235	535,685	551,948
Adoption of AASB 15/1058					(15,194)		
Net result for the year		12,742	(1,459)	2,670	5,098	5,995	6,977
Gain (Loss) on revaluation		638	3,418	792	59,546	10,268	63,950
Closing Equity	**467,434**	**480,814**	**482,773**	**486,235**	**535,685**	**551,948**	**622,875**
Variation		2,107	2,142	2,088	2,124	1,588	853

12.8.2. The year-to-date cash movement has a further imbalance of $2.572 million indicates a net understatement of income and expense from the other funds over six years.

General Fund	2016 GF Amalgimated	2017 GF Actual	2018 GF Actual	2019 GF Actual	2020 GF Actual	2021 GF Actual	2022 GF Actual
Reconciliation of result to Net Cash							
Operating Surplus/(Deficit) for the Year		11,623	1,959	3,462	64,644	16,263	70,927
Adoption of AASB 15/1058					(15,194)		
Change in Operating Assets and Liabilities							
Decrease/(Increase) in Receivables		4,543	180	(1,471)	(611)	(4,187)	1,917
Decrease/(Increase) in Inventories		219	286	86	52	44	47
Decrease/(Increase) in Other Assets		165	(124)	121	43	(335)	(165)
Decrease/(Increase) in Investment Assets		0	72	(340)	0	0	(51)
Decrease/(Increase) in Fixed Assets		(791)	(5,729)	(2,987)	(67,566)	(19,017)	(74,204)
Increase/(Decrease) in Payables		(2,414)	215	266	(266)	1,472	1,506
Increase/(Decrease) in other provisions		541	(755)	690	789	506	206
Increase/(Decrease) in Borrowings		(355)	(415)	(451)	(45)	200	(368)
Increase/(Decrease) in Contract Liability		0	0	429	8,783	(583)	5,075
NET CASH FLOW FROM ALL ACTIVITES		**13,531**	**(4,311)**	**(195)**	**(9,371)**	**(5,637)**	**4,890**
Opening Cash		22,990	40,385	36,109	35,860	26,525	20,352
Closing Cash		40,385	36,109	35,860	26,525	20,352	24,469
Increase/(Decrease) in Cash		**17,395**	**(4,276)**	**(249)**	**(9,335)**	**(6,173)**	**4,117**
Cash Movement to Cash & Cash Equilevent		(3,864)	(35)	54	(36)	536	773

12.9. Further, by applying an overhead of 15% on Employee Benefits, Materials & Services and Other Expenses to the Water and Sewer funds, there is a potential understatement of $6 million over seven years to the General Fund. This charge is required to recover administration functions such as Payroll, Human Resources, Accounts payable and Accounts Receivable.

12.10. After applying the missing estimate internal overhead charges, $7.224 Million. Potential General Fund operational cash flow shows an increase of $5.69 Million as opposed to a reduction in cash of $1.534 Million.

		2017	2018	2019	2020	2021	2022	2023
Overhead Adjustment 15%								
Water Fund Adjustment		794	738	488	508	471	471	446
Sewer Fund Adjustment		419	422	510	463	506	506	483
Total Missing Income		**1,212**	**1,159**	**998**	**971**	**977**	**977**	**929**
								7,224
Reported GF Total Cash	22,990	40,385	36,109	35,860	26,525	20,352	20,352	21,456
Adjusted GF Cash Balance	22,990	41,597	38,480	39,229	30,865	25,670	26,647	28,680
Reported GF Cash movement								(1,534)
Adjusted GF Cash movement								5,690

12.11. Council's 35% SRV over two years increased income by approximately $3million. The misstatement of General Fund accounts since amalgamation is approximately double the SRV applied. Council is now applying for another SRV.

12.12. Further analysis of SVC's ledger and setup is required to confirm the above variation. This analysis needs to include interfund accounting is set up correctly and all internal transactions have been posted.

12.13. Council is replacing its WF assets at only 13% of its depreciation, SF at only 17% of depreciation. Its clear action needs to be taken in this area. However, this has no impact on any SRV. GF assets is being replaced at 168% of Depreciation. The accelerated asset replacement has a direct impact on Councils operating result and Council needs to slow down its asset replacement program. One factor that has an impact is on asset replacement is asset destroyed due to natural disasters or arson and a line in the asset note to clarify asset replacement outside Councils routine asset replacement program would assist with clearer reporting.

12.13.1. A further issue is how Council accounted for leave liability prior 2021.

12.13.1.1. Oncosts were treated as an internal charge and not an actual cost of services. AASB 119 treats accrued leave as an expense when the service is provided with the accrued leave recognised as a liability and leave taken paid out of the liability account. SVC oncost process was to post an expense to the wage account and a negative expense to an admin number in General Fund P&L. These transactions were reversed during the Financial Report preparation process. When leave was taken it was treated as an expense through the P&L to the employee's home PJ. If an employee with a home PJ in the General Fund booked time to Water or Sewer Fund this expense is excluded as part of the report preparation process. The effect is to overstate General Fund expense and understate Water and Sewer expenses.

12.13.2. Conclusion,

12.13.2.1. Council needs to perform a major overhaul of its finance system to allow true and reconciled set of SPFS and retro preparer Note D1 for the seven years since amalgamation.