

# **REPORT OF THE REVIEW OF THE LOCAL GOVERNMENT ACCOUNTING AND OTHER FINANCIAL REGULATIONS, IN RELATION TO THE LOCAL GOVERNMENT ACT 1999**

## **BACKGROUND**

This Report sets out recommended action to update the Local Government Accounting Regulations and other financial regulations under the Local Government Act 1999, in response to the comprehensive revision of the Local Government Act 1934. In the view of the Joint Working Party the recommendations represent essential and minimum requirements for regulations clarifying the financial and accounting framework for councils and council and regional subsidiaries constituted under the Local Government Act 1999.

It is proposed to replace the current Local Government Accounting Regulations, Local Government (Long Service Leave) Regulations and Local Government (Section 166a – Insurance) Regulations with a single set of Local Government Financial Regulations, to complement the Local Government Act 1999. No change is suggested to the current wording of the Local Government (Long Service Leave) Regulations or the Local Government (Section 166a – Insurance) Regulations, except for updating of name changes and references to the relevant legislation.

A Joint Working Party comprising of staff from the Office of Local Government and the Local Government Association's Financial Advisory Committee was set up to review the three sets of regulations indicated. David Hope, of Skilmar Systems, a consultant with experience in local government financial matters and an extensive knowledge of the South Australian and interstate local government environments supported the Joint Working Party.

The Joint Working Party met on a number of occasions. Initial proposals for change were sent to the following groups for consultation:

- all South Australian councils;
- the Local Government Association;
- Local Government Auditors;
- the Local Government Financial Management Group;
- the Institute of Municipal Management;
- the Australian Bureau of Statistics; and
- the SA Local Government Grants Commission.

The consultation period was from July 21, 1999 to August 31, 1999. Included in the consultation program were two seminars, one for councils, professional bodies and other industry groups and one for local government auditors. Both sessions provided useful feedback in the process. Additionally, written comments were received from five

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councils and one local government auditor. All of the seminar comments and written material were considered by the Joint Working Party in arriving at the attached recommendations.

### **POLICY CONTEXT OF THE NEW ACT**

The Review of the Local Government Act as a whole has been informed by current precepts of minimising and simplifying legislation. In addition, themes in the general policy directions for the new Local Government Act with relevance to regulations affecting financial management include:

- ensuring a framework for open, accountable, efficient and effective Local Government;
- enabling Local Government to reach the best standards for public sector management and performance.

More specific policy directions underlying the legislation that are relevant in this area are to:

- Ensure that accounting and auditing requirements support transparency and accountability;
- Increase emphasis on performance measures, both financial and non-financial; and
- Give force to relevant national standards; and
- Emphasise ease of access for communities and elected members to financial reports, with a linkage between financial and non-financial information.

### **LEGISLATIVE PROVISIONS ON FINANCIAL MANAGEMENT**

The new Local Government Act includes provisions relating to:

- Budgets;
- Accounting records;
- Internal control and audit committees;
- Financial statements;
- Audit and auditors;

for, and of, councils, council subsidiaries and regional subsidiaries.

Many of the provisions are similar to the previous Act, with the main points of difference being:

- The preparation of an annual statement, as part of the budget process, which addresses the council's principal activities and the financial and non-financial measures it will use to assess performance against objectives;
- The requirement for each council to have a system of internal control (although this requirement was in the Local Government Accounting Regulations);

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- Encouragement for councils to establish audit committees;
- Revised criteria on who may be a council auditor;
- Revised provisions relating to the conduct of council audits; and
- An improved framework for the financial management of local government subsidiaries, which significantly improves the accountability of subsidiaries.

### **POLICY AIM OF NEW REGULATIONS**

The current Local Government Accounting Regulations were created in 1993, as a result of the introduction of a new accounting standard for government – “AAS27 – Financial Reporting by Local Governments”. In keeping with the precepts outlined above the underlying philosophy in developing those regulations was to minimise unnecessary prescription and rely on the requirements of AAS27 and other Australian Accounting Standards to provide an effective framework for financial management in local government. It is proposed to maintain that philosophy, making only such changes as are necessary to meet the provisions of the new Local Government Act. The substantive changes proposed are:

- Extending many of the current (and new) provisions to council and regional subsidiaries to make it clear that the principles of financial management and accountability in the Act also apply to those entities;
- Requiring the external reporting on functions and activities to be on a full cost basis from July 1, 2002;
- Strengthening the provisions relating to the supply of supplementary financial information;
- Including a requirement for council audits to be conducted in accordance with applicable auditing standards; and
- Incorporating the relevant provisions of the Local Government (Long Service Leave) and Local Government (Section 166a – Insurance) Regulations.

In developing the recommendations outlined below the Joint Working Party was mindful of the need for a desirable balance between achieving consistency across the sector and the ability of councils to respond to the diverse needs of their own community.

### **OVERVIEW OF REQUIREMENTS IN OTHER STATES**

New South Wales, Victoria and Queensland financial and accounting regulations are all relatively short. It is difficult to make a comparison because they do not necessarily cover the same topics and provisions in respect to each other. However, both New South Wales and Queensland also promulgate a detailed set of standards to apply to

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local government financial management. Victoria has published a number of Accounting Instructions through its Office of Local Government.

In South Australia, the Local Government Association published an Accounting Manual in 1993, associated with the introduction of AAS27, which complements the current Local Government Accounting Regulations and which it is anticipated will continue. In addition, the Local Government Association is currently tendering for the development of a Financial Management Framework manual/guideline which will assist in raising the standard of local government financial management by providing guidance to officers and elected members in the development of sound policies and procedures in financial matters.

## RECOMMENDED REGULATIONS

**Definitions** - The current regulations contain certain definitions, which are included in various accounting standards, and the use of those terms is only in the schedule to the regulations. It is recommended that these definitions not be retained. It is also recommended that specific reference to AAS27 be removed. It is only one of several Australian Accounting Standards that apply to local government.

Definitions recommended for retention/inclusion are as follows:

"Australian Accounting Standard" means any Australian Accounting Standard, as promulgated and amended from time to time by the Institute of Chartered Accountants in Australia and the Australian Society of Certified Practising Accountants;

"budget" means the budget prepared by a council under section 123 of the Act or the budget prepared by a council subsidiary under clause 9 of Schedule 2 to the Act or the budget prepared by a regional subsidiary under clause 25 of Schedule 2 to the Act;

"equity" means the residual interest in the assets of a council, a council subsidiary or a regional subsidiary left after the deduction of its liabilities;

"financial statements" are constituted by the following:

- (a) an operating statement;
- (b) a statement of financial position;
- (c) a statement of changes in equity;
- (d) a statement of cash flows;

prepared by a council under section 127 of the Act or by a council subsidiary under clause 12 of Schedule 2 to the Act or prepared by a regional subsidiary under clause 28 of Schedule 2 to the Act, and include appropriate notes and other explanatory documents relating to the financial affairs of a council, a council subsidiary or a regional subsidiary;

"full cost attribution basis" means a system of identifying the costs of functions, activities, goods and services where indirect and overhead costs which should be allocated to a function, activity, good or service have been allocated on a reliable and consistent basis that may be unique to a particular council;

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"infrastructure" means assets which are integral to public facilities that provide essential public services and which, once constructed, have indefinite lives of a long-term nature<sup>1</sup>

"material" has the same meaning as in Australian Accounting Standard AAS 5;

**Form of Budget** – The format of the budget should ensure that comparability is maintained between the budgeted financial statements and the end-of-year financial statements. The current Regulation 5 is not required – councils may use whatever format is useful to them for reporting on functions and activities but must be in a position to review the budget at the necessary intervals and to report at year's end in the form specified for nature and type financial statements with comparisons against the budget

The set of budgeted financial statements should be extended to include a budgeted Statement of Changes in Equity. The current regulations require the budgeted financial statements to be revised when the budget is revised, but this is considered an unnecessary imposition, although Councils may continue to do so – refer note.

Specific recommendations are as follows:

In adopting its budget for a financial year a council must ensure that the principle of comparability is maintained by ensuring that a direct comparison can be made between budget and actual by including in the budget documents:

- (a) a budgeted operating statement;
- (b) a budgeted statement of financial position;
- (c) a budgeted statement of changes in equity;
- (d) a budgeted statement of cash flows;
- (e) a statement reconciling cash and non-cash revenues and expenses, which demonstrates the basis for the quantum of rates to be raised.

Items (a) to (d) must be in the format set out in the schedule.<sup>2</sup>

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<sup>1</sup> Examples: Roads, footpaths, bridges, storm-water drains, common effluent drainage systems, water pipes, windmills, jetties, monuments, bores.

<sup>2</sup>The budgeted financial statements may be revised when the council's budget is revised.

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**Reconsideration of Budget** – A regulation, similar to the current Regulation 6, is recommended requiring councils to regularly reconsider their budgets. The first such reconsideration, in line with the recommended regulation, must consider the financial statements for the previous year.

Specific recommendations are as follows:

A council, a council subsidiary or a regional subsidiary must reconsider its budget at least three times, at intervals of no less than three months, between 30 September and 31 May.

The first reconsideration of the budget should include the consideration of the audited financial statements for the previous financial year.

**Accounting Records** - The current Regulation 7 makes provision for the manner in which councils must keep their accounting records. A similar regulation is recommended which also extends the requirement to council and regional subsidiaries.

It is also recommended that the use of a full cost attribution basis of accounting for externally reported financial information about functions and activities be a requirement, with effect from July 1, 2002. Modern standards of accountability increasingly require public sector authorities to be able to identify the full costs of provision of goods and services, whether for consideration of the desirability of outsourcing, assuring compliance with national competition policy, or to demonstrate the implications of decisions in a more general sense. The recommendation complements moves by the Local Government Association to ensure that supplementary information provided to the Australian Bureau of Statistics is on a full cost basis.

Specific recommendations are as follows:

A council, a council subsidiary or a regional subsidiary must ensure that all accounting records, accounts and financial statements are prepared and maintained in accordance with all applicable Australian Accounting Standards.

No later than 1 July 2002 a council, a council subsidiary or a regional subsidiary must ensure that any external financial reporting of functions, activities, goods and services is prepared and reported on a full cost attribution basis.

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**Revaluation of Assets** – The current Regulation 8 makes provision to revalue assets based either on a timeframe set by Australian Accounting Standards or every five years. It is recommended that this requirement be varied so that it applies only to land and infrastructure assets and that it extend to council subsidiaries and regional subsidiaries.

Specific recommendations are as follows:

A council or a council subsidiary or a regional subsidiary must undertake a revaluation of all material non-current assets in accordance with the relevant Australian Accounting Standards.

If the Australian Accounting Standards do not prescribe a period for the revaluation of land and infrastructure assets, the council, council subsidiary or regional subsidiary must ensure that land and infrastructure assets are revalued at least once in every five years.

A revaluation may be undertaken on a rolling basis for different classes or categories of assets.

**Format of Financial Statements** – AAS27 requires councils to report by both nature and type of revenues/expenditures and functions and activities. The current Regulation 9 over-controls what councils may do and restates principles embodied in AAS27. It is recommended that the regulation be simplified to require that the report on nature and type of revenues/expenditures follow the format of the recommended schedule. This will provide for a measure of consistency in examining local government financial reports.

Specific recommendations are as follows:

A council's financial statements relating to nature and type of expenditure must follow the format set out in the schedule.

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**Certification and Adoption of Financial Statements** – The current regulation 10 is recommended to be retained with some minor changes in wording to reflect the statutory provision accurately and with the removal of the now inappropriate requirement for the CEO to sign the council adoption statement.

Specific recommendations are as follows:

The following statements must be included on the final page of the financial statements of a council:

**CHIEF EXECUTIVE OFFICER'S STATEMENT**

I, \_\_\_\_\_ the person for the time being occupying the position of Chief Executive Officer of the

do hereby state that the Statement of Financial Position of the \_\_\_\_\_ as at 30 June 20XX

and the Operating Statement, Statement of Changes in Equity and the Statement of Cash Flows, together with the notes and explanatory documentation attached, for the year ended on that date is to the best of my knowledge presented fairly and in accordance with accounting procedures which have been maintained in accordance with the Local Government Act 1999, and the Local Government Financial Regulations made under that Act.

(Signed)

Dated

Chief Executive Officer

**ADOPTION STATEMENT**

Laid before the  
and adopted on  
Mayor or Chairman

**Prescribed Day for Completion of the Preparation of the Financial Statements** – Section 127 of the Act requires the prescription of a day by which the financial statements must be prepared. The prescription of this date is constrained by the fact that the Act permits auditors to take two months to complete their audit, and it is proposed to prescribe that the audited financial statement to be sent to the Minister by November 30 (the current provision). The preparation and reporting of financial information is an important element of accountability. Some councils are still finalising their budgets at this time and need encouragement to prioritise the financial statement preparation so that an appropriate level of accountability is achieved.

Specific recommendations are as follows:

The prescribed day for the purposes of section 127(2) (a) of the Act should be the second Friday in each September. This is the last day by which the financial statements must be made available to the council's auditor.

**Prescribed Day for Forwarding Financial Statements to the Minister** - The current Regulation 12 prescribes November 30 as the day by which the financial statements, including supplementary financial information, of a council must be sent to the Minister, the Local Government Grants Commission and the Australian Bureau of Statistics. No change is proposed to those arrangements. However, it is recommended that the requirement for councils with electricity supply works to provide information to ETSA not be retained. It is also recommended that the council's Chief Executive Officer attest that the supplementary financial information has been reconciled with the audited financial statements.

Specific recommendations are as follows:

Pursuant to section 127(4) of the Act, a council must, on or before 30 November in each year, submit a copy of the audited financial statements of the council for the immediately preceding financial year to-

- (a) the Minister; and
- (b) the presiding member of the South Australian Local Government Grants Commission; and
- (c) the South Australian Regional Director of the Australian Bureau of Statistics.

The statements submitted must be accompanied by information that accords with the "Supplementary Data to the Financial Statements" issued by the Australian Bureau of Statistics for use by councils.

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The Chief Executive Officer of the council must attest that the information has been reconciled to and is consistent with the audited financial statements of the council.

**Internal Control** – The current Regulation 13 provides for the CEO of a council to ensure that a system of internal control is operating effectively. It is recommended that this requirement not be retained as the same effect is achieved by Sections 99 and 125 of the Act.

**Audit of Financial Statements** – It is recommended that a new regulation be included that specifies the standard to which the audit of local government entities must be conducted. The matter of the auditor giving due consideration to the adequacy of the system of internal control is already covered in the Standards. However, it is proposed that this should be given additional prominence, for emphasis.

Specific recommendations are as follows:

An audit of the financial statements of a council, a council subsidiary or a regional subsidiary, must be conducted in accordance with the Auditing Standards and Auditing Guidance Statements promulgated and published by the Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants.

In forming an audit opinion the auditor must give due consideration to the adequacy of the system of internal control.

**Audit of Council and Regional Subsidiaries** - The current Regulations 15 and 16 require Section 199 and 200 committees to have auditors and for information from audited financial statements to be provided to the constituent councils. It is recommended that those arrangements be strengthened in respect of council and regional subsidiaries and include the specification of who may be an auditor and when the office of auditor becomes vacant – as for council auditors as provided in Section 128 of the new Local Government Act.

Specific recommendations are as follows:

A council subsidiary or a regional subsidiary must have an auditor.

The auditor must be—

- a) a registered company auditor; or
- b) a firm comprising at least one registered company auditor.

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A person is not eligible to be the auditor if—

- a) the person is a member of a constituent council; or
- b) the person is a nominated candidate for election as a member of a constituent council; or
- c) the person is a member of the board of the subsidiary.

The office of auditor becomes vacant if—

- a) the auditor dies; or
- b) the auditor resigns by written notice to the chief executive officer; or
- c) the auditor is not or ceases to be eligible for appointment as the auditor; or
- d) the auditor accepts remunerated office or employment from the subsidiary or a constituent council; or
- e) the term of appointment of the auditor expires and the auditor is not reappointed; or
- f) the auditor is removed from office by the subsidiary for reasonable cause.

A council subsidiary or a regional subsidiary must prepare financial statements for each financial year which must include such information as is required by its charter under Clause 3(2)(h) of Schedule 2 to the Act in the case of a council subsidiary or Clause 20(2)(h) of Schedule 2 to the Act in the case of a regional subsidiary, and the financial statements must be audited by the auditor.

The financial statements must be prepared in sufficient time to permit the reporting or consolidation of the information required into the constituent councils financial statements by the date prescribed.

Unless otherwise required by a relevant Australian Accounting Standard, a council must, in respect of each regional subsidiary of which the council is a constituent council, include by way of a note to its financial statements information that identifies the regional subsidiary, and describes its nature and purpose, information on the financial contributions that have been made by the council to the regional subsidiary, or to the council by the regional subsidiary, during the financial year and any other relevant financial information, including information relating to financial guarantees and contingent liabilities.

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**Laying the Financial Statements of a Council or Regional Subsidiary before the Constituent Councils** – To ensure that financial information about council or regional subsidiaries becomes part of the public record, except in cases of confidentiality, it is recommended that a regulation require that the financial statements are laid before council.

Specific recommendations are as follows:

The audited financial statements of a council subsidiary or a regional subsidiary must be provided to a constituent council or councils within fourteen days of the auditor providing an audit opinion.

The audited financial statements of a council subsidiary or a regional subsidiary must be laid before a constituent council or councils for noting at the council meeting next succeeding the receipt of the financial statements by the council.

**Long Service Leave Regulations** – It is recommended that the wording of the current Local Government (Long Service Leave) Regulations 4, 5 and 6 be retained – updated for references and included in the Local Government Financial Regulations.

**Insurance Regulation** – It is recommended that Regulation 4 of the current Local Government (Section 166a – Insurance) Regulations be included in the Local Government Financial Regulations – updated for new Act reference.

**Financial Statement Schedule** – It is recommended that the current schedule to the current regulations be retained, with some amendments to the format and wording.

Specific recommendations are as follows:

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LOCAL GOVERNMENT FINANCIAL REGULATIONS 1999 - SCHEDULE

FINANCIAL STATEMENTS

**[Name of] Council**

**Operating Statement for the year ended 30 June 20xx**

	Note	20xx		20xx	
		\$	\$	\$	\$
<b>OPERATING REVENUE</b>					
Rates					
- General		XXX		XXX	
- Other		XXX		XXX	
Statutory Charges		XXX		XXX	
User Charges		XXX		XXX	
Operating Grants and Subsidies		XXX		XXX	
Investment Income		XXX		XXX	
Reimbursements		XXX		XXX	
Gain on Disposal of Non-Current Assets		XXX		XXX	
Commercial Activity Revenue		XXX		XXX	
Other		XXX		XXX	
TOTAL OPERATING REVENUE				XXX	XXX
<b>OPERATING EXPENSES</b>					
Employee Costs		XXX		XXX	
Contractual Services		XXX		XXX	
Materials		XXX		XXX	
Finance Charges		XXX		XXX	
Depreciation		XXX		XXX	
Loss on Revaluations		XXX		XXX	
Loss on Disposal of Non-Current Assets		XXX		XXX	
Other		XXX		XXX	
TOTAL OPERATING EXPENSES			XXX		XXX
Operating Surplus/(Deficit) before Capital Revenues			XXX		XXX
<b>CAPITAL REVENUES</b>					
Capital Grants, Subsidies and Monetary Contributions		XXX		XXX	
Physical resources received free of charge		XXX		XXX	
Operating Surplus/(Deficit) after Capital revenues and before Abnormal and/or Extraordinary Items				XXX	XXX
Abnormal Items				XXX	XXX
Extraordinary Items			XXX		XXX
Net Surplus/(Deficit) resulting from Operations			XXX		XXX

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[Name of] Council

**Statement of Financial Position as at 30 June 20xx**

	Note	20xx		20xx	
		\$	\$	\$	\$
<b>CURRENT ASSETS</b>					
Cash		XXX		XXX	
Receivables		XXX		XXX	
Inventory		XXX		XXX	
Investments		XXX		XXX	
Other		XXX		XXX	
<b>TOTAL CURRENT ASSETS</b>			XXX		XXX
<b>CURRENT LIABILITIES</b>					
Bank Overdraft		XXX		XXX	
Creditors		XXX		XXX	
Provisions		XXX		XXX	
Loans		XXX		XXX	
Other		XXX		XXX	
<b>TOTAL CURRENT LIABILITIES</b>				XXX	XXX
Net Current Assets/(Current Liabilities)			XXX		XXX
<b>NON-CURRENT ASSETS</b>					
Receivables		XXX		XXX	
Inventory		XXX		XXX	
Investments		XXX		XXX	
Land		XXX		XXX	
Buildings		XXX		XXX	
Equipment		XXX		XXX	
Furniture and Fittings		XXX		XXX	
Other		XXX		XXX	
<b>TOTAL NON-CURRENT ASSETS</b>			XXX		XXX
<b>NON-CURRENT LIABILITIES</b>					
Creditors		XXX		XXX	
Provisions		XXX		XXX	
Loans		XXX		XXX	
Other		XXX		XXX	
<b>TOTAL NON-CURRENT LIABILITIES</b>				XXX	XXX
<b>NET ASSETS</b>				XXX	XXX
<b>EQUITY</b>					
Accumulated Surplus		XXX		XXX	
Reserves		XXX		XXX	
<b>TOTAL EQUITY</b>				XXX	XXX

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**Statement of Changes in Equity for the Year Ended 30 June 20xx**

	Note	20xx		20xx	
		\$	\$	\$	\$
<b>ACCUMULATED SURPLUS</b>					
Balance at beginning of period		XXX		XXX	
Net Surplus/(Deficit)		XXX		XXX	
Transfers from reserves		XXX		XXX	
Transfers to reserves		(XXX)		(XXX)	
Balance at end of period			XXX		XXX
<b>ASSET REVALUATION RESERVE</b>					
Balance at beginning of period		XXX		XXX	
Transfers to reserve – Revaluation increment		XXX		XXX	
Transfers from reserve -		(XXX)		(XXX)	
Balance at end of period			XXX		XXX
<b>..... RESERVE</b>					
Balance at beginning of period		XXX		XXX	
Transfers to reserve from .....		XXX		XXX	
Transfers from reserve to .....		(XXX)		(XXX)	
Balance at end of period			XXX		XXX
<b>..... RESERVE</b>					
Balance at beginning of period		XXX		XXX	
Transfers to reserve from .....		XXX		XXX	
Transfers from reserve to .....		(XXX)		(XXX)	
Balance at end of period			XXX		XXX
<b>TOTAL EQUITY</b>				<b>XXX</b>	<b>XXX</b>

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[Name of] Council

**Statement of Cash Flows for the Year Ended 30 June 20xx**

	Note	20xx \$	20xx \$	20xx \$	20xx \$
			Inflows (Outflows)	Inflows (Outflows)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>					
Receipts			XXX	XXX	
Payments			(XXX)	(XXX)	
NET CASH USED IN OPERATING ACTIVITIES			XXX	XXX	XXX
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>					
Receipts					
Loans Received			XXX	XXX	
Payments					
Principal Repayments			(XXX)	(XXX)	
NET CASH USED IN FINANCING ACTIVITIES			XXX	XXX	XXX
<b>CASH FLOWS FROM INVESTMENT ACTIVITIES</b>					
Receipts					
Capital Grants/Subsidies			XXX	XXX	
Contributions					
Sale of			XXX	XXX	
Sale of				XXX	XXX
Payments					
Purchase of			(XXX)	(XXX)	
Purchase of				(XXX)	(XXX)
NET CASH USED IN INVESTMENT ACTIVITIES			XXX	XXX	XXX
NET INCREASE (DECREASE) IN CASH HELD			XXX	XXX	XXX
CASH AT BEGINNING OF REPORTING PERIOD			XXX	XXX	XXX
CASH AT END OF REPORTING PERIOD			XXX	XXX	XXX