CPA AUSTRALIA

A GUIDE TO UNDERSTANDING THE FINANCIAL REPORTS OF LOCAL GOVERNMENTS

Crowe Horwath.
PART OF FINDEX

CPA AUSTRALIA

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The Guide has been developed with the assistance of Martin Thompson, a Senior Partner at Crowe Horwath. Crowe Horwath, a part of Findex, is a leading provider of accounting and assurance services to the local government sector across Australia. With over 110 offices throughout Australia and New Zealand, their vast geographical footprint provides direct access to over 3,000 expert advisers and professionals. Located in most regional, rural and metropolitan areas, they are well positioned to assist local government agencies meet the challenges they are facing. Crowe Horwath's services include Audit and Assurance, Business Advisory, Corporate Benefits, Corporate Finance, Performance Consulting and Specialist Tax.

More information on Crowe Horwath and the services they provide can be found at **www.crowehorwath.com.au**

FOREWORD

Local government is the third tier of government in Australia and, in partnership with other levels of government, is responsible for aspects of everyday life that people care about deeply – from vibrant and safe public spaces, to accessible libraries, to strong local business and employment opportunities. The area covered by local councils in Australia ranges from as small as 1.5 km^2 (0.58 sq mi) for the Shire of Peppermint Grove in Perth to the Shire of East Pilbara in Western Australia, which covers 380,000 km^2, an area larger than Germany or Japan.

All local governments are approximately equal in their theoretical powers, although Local Government Authorities (LGAs) that encompass large cities such as Brisbane and the Gold Coast command more resources due to their larger population base. The councils' chief responsibility in the first half of the 20th century was the provision of physical infrastructure such as roads, bridges and sewerage. From the 1970s the emphasis changed to community facilities such as libraries and parks, maintenance of local roads, town planning and development approvals, and local services such as waste disposal. Child care, tourism and urban renewal were also beginning to be part of local governments' role.

However, the roles of local government areas in Australia have recently expanded as higher levels of government have devolved activities to this tier. Examples include the provision of community health services, regional airports and environmental management as well as community safety and accessible transport. The changes in services have been described as a shift from 'services to property' towards 'services to people'. Community expectations of local government in Australia have risen in the 21st century partly as a result of wider participation in decision making and transparent management practices.

Recent years have seen some state governments devolving additional powers onto LGAs. In Queensland and Western Australia LGAs have been granted the power to independently enact their own local subsidiary legislation, in contrast to the previous system of by-laws. Councils also have organised their own representative structures such as Local Government Associations and Regional Organisations of Councils.

Local government revenue comes from three main sources - taxation (rates), user charges and grants from federal and state/territory governments. A fourth source, categorised as 'miscellaneous' by the ABS (Australian Bureau of Statistics), consists of revenue raised through the likes of investment interest, dividend interest, income from public enterprise and fines.

Rates account for about 37 per cent of total revenue. Rates comprise just 3.3 per cent of tax raised by all levels of government and is the only tax levied by local government, of 260 taxes in Australia. About one quarter of total local government revenue comes from user charges. Overall, grants and subsidies from the Australian and state/territory governments account for around 10 per cent of total revenue. For some rural and remote councils where own-source revenue raising capacity is limited, grants can account for more than 50% of council revenue.

The Australian Government provides financial assistance grants to local government. These are paid to state governments for distribution to local government via state grants commissions. Councils are able to apply for funding under a range of Australian Government programs, such as the Road Safety Black Spot program, Roads to Recovery, Bridges Renewal Program and the Building Better Regions fund.

Local government assets have a net worth of more than $333 billion (2012-13).

CPA Australia's *A guide to understanding the financial reports of local governments* will be of value to a range of stakeholders, including Councillors, ratepayers and others, to better understand the accounting and regulatory aspects of local government financial reporting. This is the first in a series of initiatives that CPA Australia intends to undertake to improve the financial literacy and understanding of financial performance measures of LGAs.

The guide is an initiative of the Public Sector Network (PSN) of CPA Australia. The guide has also benefited from a working group of CPA Australia members who have brought to the fore their valuable expertise in the development of this guide. I congratulate the PSN and the working group on their contribution to this CPA Australia publication, which has an important role to play in the promotion of financial literacy.

Peter Wilson AM FCPA
President & Chairman of the Board
CPA Australia Ltd

INTRODUCTION

THE PURPOSE OF THIS GUIDE

Councils manage significant finances on behalf of their communities. They must responsibly manage these finances in order to provide the services and facilities that are needed.

There are four generally accepted principles of sound financial management for councils. In some jurisdictions these principles are incorporated in legislation. The principles of sound financial management require councils to:

- manage financial risks prudently, having regard to economic circumstances
- pursue spending and rating policies that are consistent with a reasonable degree of stability in the level of the rate burden
- ensure that decisions and actions have regard to financial effects on future generations
- **ensure full, accurate and timely disclosure of financial information relating to the council.**

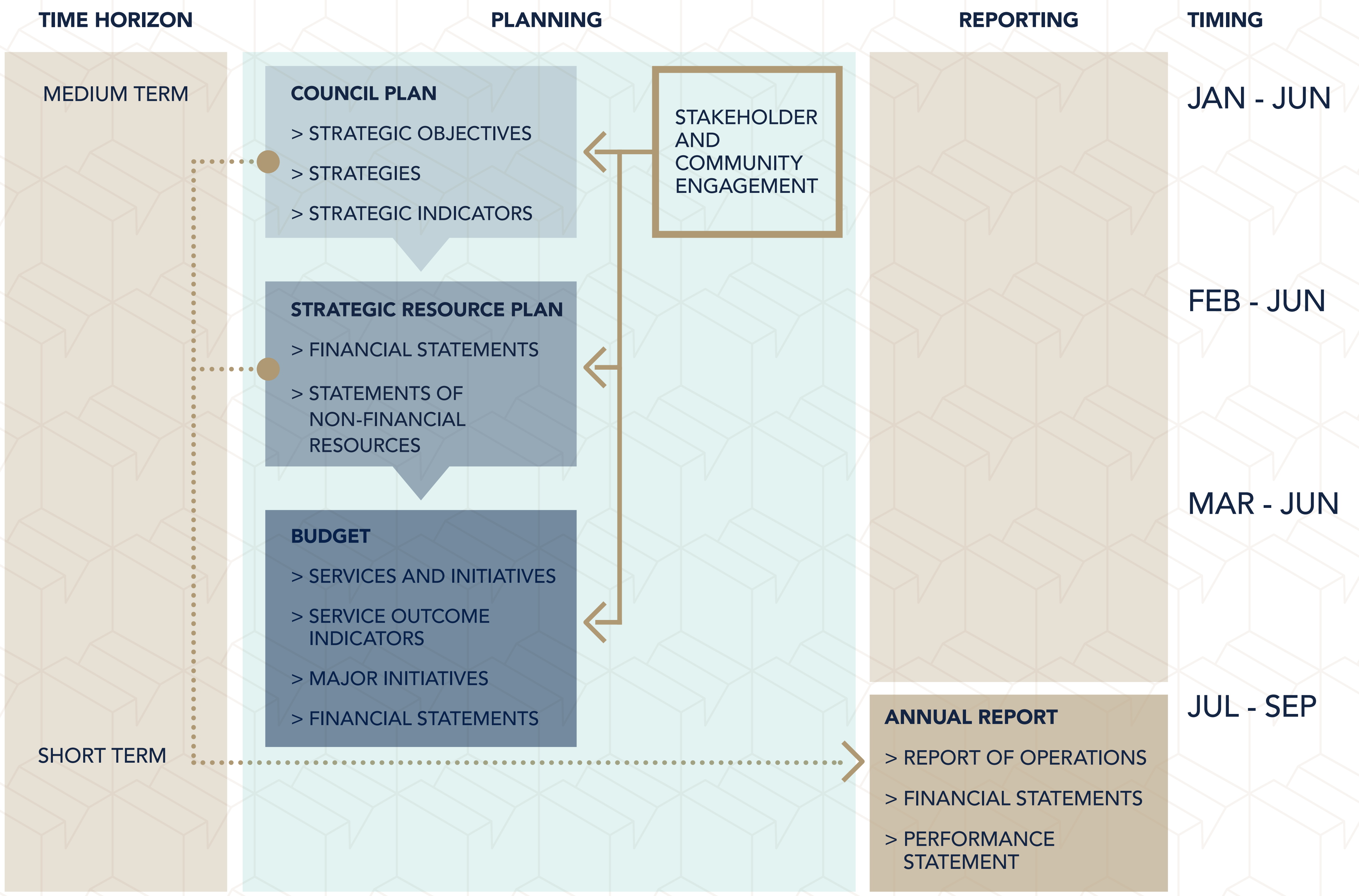
This guide has been prepared to assist in meeting the objectives of the fourth principle, financial reporting. While this guide focusses on the annual financial report it is important to note that the financial report sits within a broader financial management framework. The below diagram provides an overview of this framework as it applies in the Victorian context.

It is also important to note that the financial reporting function is an ongoing activity, with regular reports provided to council to assist in the timely management of council resources and to address emerging issues.

This guide is intended for the users of financial statements prepared by councils in Australia, such as Councillors, ratepayers, community groups and other interested parties. In addition, the management and staff of LGAs may also find the guide useful. The guide will assist users to better understand the content of the financial statements.

To assist understanding, the guide provides extracts from the financial statements of My Town City Council (My Town), a fictitious Council. It should be noted that the example provided does not constitute a full set of financial statements and the extracts are presented only to demonstrate key aspects of the financial statements of a council. In addition, the guide includes some general material about the Australian local government sector.

This guide has been prepared as a general aid to understanding financial reporting by councils. The guide does not cover a range of specific reporting or disclosure requirements that may apply in individual jurisdictions.



Victorian Planning and Accountability Framework (Source – LGV Model Budget 2018-19)

THE LOCAL GOVERNMENT SECTOR

The six states and Northern Territory have established a third level of government through legislation. Local governments (also known as councils) handle many community needs like roads, waste collection, public recreation facilities and town planning (excluding the Northern Territory). The states and the Northern Territory each have many councils within their borders. The state or territory government defines the powers of the local governments, and decides what geographical areas those governments are responsible for.

In the Australian Capital Territory, the responsibilities usually handled by local government are administered by a department of the territory government.

While the breadth and depth of services provided varies across jurisdictions, all councils have a common set of objectives associated with the provision of infrastructure and services to local communities.

The activities of councils have a significant impact on the communities they serve. Councils have been created for delivering services directly to local communities and as such are often seen as having the highest level of direct interaction between the governing body (council) and the community they serve. Because of these unique attributes, laws and regulatory frameworks have been developed in each state and the Northern Territory to govern the operations of councils.

WHY ARE FINANCIAL STATEMENTS REQUIRED?

Financial reporting by councils provides information to users to assist their decision-making and to demonstrate effective stewardship and accountability. Councils are normally accountable to those that provide them with resources, and those that depend on them for the services or goods they provide. In addition, and like other tiers of government, councils are also subject to a high level of community interest and accountability.

The financial reporting by councils provides information on how they have discharged their accountability obligations for the management of the public monies and assets entrusted to them, and the delivery of services or goods to stakeholders, compliance with legislation, or other authority that governs the delivery of services or goods and other operations.

Council financial statements are independently audited. This is undertaken to comply with the requirements of the various local government acts across the jurisdictions. The audit processes provide an independent level of reasonable assurance that the financial report is materially correct. It is important to note that the audit process provides an opinion on the financial report, but not on the effectiveness or otherwise of the systems and processes implemented by council management to control the financial transactions of council. With the exception of South Australia and the Northern Territory, the audit is undertaken by the relevant state (or territory) Auditor-General. In South Australia and the Northern Territory the auditor is appointed by the council.

The form and content of financial statements prepared by a council is usually determined by the relevant local government act, and all financial statements are required to comply with the Australian Accounting Standards that govern the preparation of general purpose financial statements. Within each state and territory legislation, regulation or direction may result in additional information being required to be included, or presented in a particular manner.

This guide includes excerpts from the financial statements of My Town City Council – a generic council with disclosures applicable to all jurisdictions. Specific additional requirements of individual jurisdictions have not been incorporated into the illustrative examples.

WHAT ARE FINANCIAL REPORTS?

Across the local government sector, differences exist in the form and content of financial reports in different jurisdictions. Primarily, these differences arise due to the legislative or regulatory framework in place for the preparation of the financial reports. While differences exist, the substantive base of financial reporting is consistent across all jurisdictions. All councils share a significant core in terms of the basis of preparation, including the matters discussed in the following paragraphs.

People often use the terms "financial statements", "financial report" and "annual report" interchangeably when talking about the annual financial accountability documents produced each year by councils. However, each of these terms has a different meaning in the local government context.

These are explained as follows:

- Financial statements, these are the primary or main part of the financial report. Although the names may vary slightly they all include:
  - A statement detailing the income and expenditure of the council, often known as the statement of comprehensive income. This is presented on an 'accrual' basis, that is it records revenue when it is earned and expenses when they are incurred, regardless of the timing of the receipt or payment of cash.
  - A statement detailing the assets and liabilities of the council, often referred to as a statement of financial position or a balance sheet. The assets and liabilities are generally measured at their 'fair value' which may be different to the historic cost. For example, long life infrastructure assets, such as roads, are measured at the current estimated cost to replace, adjusted to reflect the current condition of the asset while land and non-specialised buildings are usually recorded at market value.
  - A statement detailing the changes in equity (or the net assets) of the council. This statement details the movement in the net assets of a council, allocated between retained earnings and movements in other reserves.
  - A statement of cash flows of the council. This statement provides details of the cash receipts and payments of council for the year. The statement separates cash flows into operating activities, such as the receipt of rates or payment of staff, investing activities, such as capital works and the purchase of assets and financing activities, such as the receipt of borrowed funds or the repayment of loans.
- The financial report is the broader document, within which the financial statements appear. This financial report includes a range of notes providing additional information and explanations in relation to the financial statements. In addition, the financial report will include a statement (or certification) from management about the basis for the preparation of the financial report and that it presents fairly the financial result and position of council. The financial report will also include the auditor's opinion on the financial report, this is a critical document as it will highlight any qualification or significant matter that the auditor wants the reader of the report to be aware of.

The term 'annual report' is less defined but is generally considered to include all documents that are prepared annually by a council to inform readers about its activities and achievements, performance and financial position for the year. Normally the annual report will incorporate the financial report, as well as other information about its operations.

WHAT ARE FINANCIAL REPORTS?

INFRASTRUCTURE, VALUATION AND DEPRECIATION

Councils control significant physical assets. Many of these assets are long life assets that are subject to significant changes in value over the period council holds them. As a result, and in an effort to ensure financial information is relevant to users of the financial statements, physical assets, such as infrastructure (roads, water, sewerage, storm water drains, bridges) and buildings are measured and presented at their fair value.

Under this approach, assets are re-measured periodically to reflect changes in their current value, with the resulting change, generally, being reflected in an asset revaluation reserve. The result is a balance sheet that better reflects the current replacement cost of assets.

In councils, the revaluation process is typically achieved by determining how much it would cost to replace an existing asset (replacement cost). For example, the financial value of a length of road could be measured by identifying the cost of constructing a similar length of road. This value is then adjusted to reflect the current condition of the asset, resulting in the determination of a depreciated current replacement cost, often referred to as the net carrying amount.

EXAMPLE – VALUATION OF A COUNTRY ROAD

My Town, is undertaking a revaluation of its road network. The Manager of Infrastructure is currently in the process of revaluing Jetty Lane, a 3km stretch of country road. The manger inspects the road as part of the revaluation, and based on his expert knowledge, assesses that the road when constructed would have had a life of 30 years, however based on its current condition has a remaining life of 15 years.

Back in his office, the manager reviews the current construction costs for council to build a road to the same specification and standard as Jetty Lane. Based on this the manager determines the cost per km to build a new road at $450,000. Using this information, the manager can determine the replacement cost of Jetty Lane as follows:

REPLACEMENT COST = 3 × $450,000 = $1,350,000

This replacement cost then needs to be adjusted to reflect the current condition of Jetty Lane. This is done by 'depreciating' the current replacement cost to reflect the condition of Jetty Lane. The amount of Depreciation is determined as follows:

DEPRECIATION = remaining life (15 years) / by total life (30 years) × replacement cost ($1,350,000) = $675,000

This depreciation amount represents the value of Jetty Lane that has been consumed, based on its current replacement cost. Using this information the manger will incorporate the following information into the financial records of council.

JETTY LANE:	Current replacement cost;	$1,350,000
	Accumulated depreciation	$675,000
	Carrying value:	$675,000

ELEMENTS OF COUNCIL FINANCIAL REPORTS

STATEMENT OF COMPREHENSIVE INCOME

The example statement of comprehensive income of My Town Council includes income and expense types common to councils, such as:

COMPREHENSIVE INCOME STATEMENT		
FOR THE YEAR ENDED 30 JUNE 2018		
	2018	2017
	$'000	$'000
INCOME		
RATES AND CHARGES	166,712	161,428
STATUTORY FEES AND FINES	15,397	13,476
USER FEES	14,329	13,055
GRANTS – OPERATING	16,861	12,158
GRANTS – CAPITAL	1,360	4,290
CONTRIBUTIONS – MONETARY	6,224	7,554
CONTRIBUTIONS – NON-MONETARY ASSETS	12	423
OTHER INCOME	8,732	9,645
SHARE OF NET PROFITS OF ASSOCIATES AND JOINT VENTURES	-	525
TOTAL INCOME	**229,627**	**222,553**
EXPENSES		
EMPLOYEE COSTS	(83,555)	(77,856)
MATERIALS AND SERVICES	(64,205)	(54,400)
BAD AND DOUBTFUL DEBTS	(935)	(866)
DEPRECIATION AND AMORTISATION	(31,833)	(30,547)
BORROWING COSTS	(2,535)	(2,719)
OTHER EXPENSES	(10,642)	(10,564)
NET LOSS ON DISPOSAL OF PROPERTY, INFRASTRUCTURE, PLANT AND EQUIPMENT	(3,657)	(4,481)
SHARE OF NET (LOSSES) OF ASSOCIATES AND JOINT VENTURES	(3,657)	(4,481)
TOTAL EXPENSES	**(198,005)**	**(181,432)**
SURPLUS FOR THE YEAR	**31,622**	**41,121**
OTHER COMPREHENSIVE INCOME ITEMS THAT WILL NOT BE RECLASSIFIED TO SURPLUS OR DEFICIT IN FUTURE PERIODS		
NET ASSET REVALUATION INCREMENTS	244,682	566,583
TOTAL COMPREHENSIVE RESULT	**276,304**	**607,704**

INCOME

Rates and Charges – these are the taxes levied on ratepayers within the council. Rates are most commonly based on the valuation of the property subject to charge. A number of methods are employed for calculating rates payable by property holders, however all are linked to either the valuation of the property or its capacity to generate income (such as rental). Within a council, differential rates may be used to distribute the rating burden between different types of properties. Common differential rates may be applied for residential, commercial and farm properties. In addition to rates other specific charges may also be levied as part of the rating process. For example, many councils will include a charge for waste collection as part of the overall rates and charges. Typically, these charges are based on the cost of providing the service and will be levied without regard to the specific property valuation. Each jurisdiction has specific and sometimes complex legislative requirements regarding the levying of rates and charges.

Statutory fees and Fines – A key function of a council is the administration of a range of regulatory functions. These can vary from administering the town planning process through to parking enforcement. Under this regulatory function there will be a range of fees and fines that will be levied by the council. These can be distinguished from user fees and charges (defined below) in that the amount of the fee or fine is (often) set externally (by statute or regulation) and the payment is compulsory.

User fees – All councils generate a level of income through the charging of fees for goods and services. The fees can vary from admission to an aquatic facility through to the payment of a hall hire fee. The one characteristic that all user fees and charges have is that they are entered into at the election of the user rather than as a result of any legislative or regulatory compulsion.

Operating Grants – All councils rely, to a certain extent, on the provision of operating grants to fund the delivery of services. Operating grants typically fall into one of two categories:

- Financial Assistance Grants received that are federally funded and allocated via state and territory based Grants Commissions. These funds are usually untied and can be used to assist in the delivery of any council services.
- Tied grants, received from state, territory and federal sources that are linked to the delivery of specific programs, for example community care or wellbeing services.

Capital Grants – External funding from the other levels of governments to assist in the acquisition, development and renewal of community assets. These grants are mainly non-recurring in nature essentially for the purposes of funding the purchase of a large asset or capital works project and are usually expended by councils to construct new or upgrade existing assets. The grants are in addition to the funds allocated by council to the capital works project. These grants are normally recognised in results when received.

Monetary and Non-Monetary Contributions – councils receive monetary and non-monetary contributions, typically from developers, in relation to the development or redevelopment activities occurring within the municipality. Non-monetary contributions are received in the form of gifted assets, such as roads, footpaths, drainage and other community facilities, which are brought to account by the council at their fair value. Monetary contributions are received to assist the councils deliver additional infrastructure that is required to service new developments.
It is important to note that, while adding to a council's income, contributions, particularly non-monetary contributions, do not lead to an increase in realisable assets (or funds) available to meet future obligations.

ELEMENTS OF COUNCIL FINANCIAL REPORTS

COMPREHENSIVE INCOME STATEMENT		
FOR THE YEAR ENDED 30 JUNE 2018		
	2018 $'000	2017 $'000
INCOME		
RATES AND CHARGES	166,712	161,428
STATUTORY FEES AND FINES	15,397	13,476
USER FEES	14,329	13,055
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EXPENSES

Employee costs – These represent the total cost of staff employed in the delivery of council services. The costs are typically inclusive of items such as wages, superannuation, employee leave entitlements and other on costs. These costs are also likely to include temporary or casual staff employed to assist in the delivery of services. In general, they will not include the costs of engaging contractors providing services to the council on an outsourced basis.

Materials and Services – These are the costs incurred in the purchase of material or other services necessary to deliver council services. The actual costs can be extremely varied; accordingly, councils will often include a note providing a breakdown of the types of costs that make up this category. More significant categories of expenditure within materials and services include:

- Contractor payments
- Maintenance costs
- Utilities
- ICT costs
- Consultants and professional services

Bad and Doubtful debts – These are the costs associated with the provision for or writing off of bad or doubtful debts. Councils often have a high level of write off in relations to fines due to the inherently difficult nature of collection. Other receivables such as those related to rates have a very low level of write off due to councils having the ability to recover any outstanding amounts at the time of sale of the subject property or otherwise through legal action.

Depreciation and Amortisation – The consumption of property, infrastructure, plant and equipment is measured through depreciation for physical assets and amortisation for non-physical assets. This is recognised as a cost to council and is measured as an estimate of the reduction of the future value of the assets over the period. While this is a significant cost, it does not represent a cash outflow to the council.

Borrowing costs – These are the costs associated with borrowings held by council, typically interest. In certain, qualifying, cases rather than recognised as a cost, borrowing costs can be incorporated into the cost of an asset purchased or constructed by council.

ELEMENTS OF COUNCIL FINANCIAL REPORTS

STATEMENT OF FINANCIAL POSITION (OR BALANCE SHEET)

Councils hold and operate a range of different assets that provide future economic benefits. Some of these assets that are held, and provide benefit, over the long term are classified as non-current assets. Assets that provide benefits over the short term (usually within one year) are classified as current assets. In fulfilling their objectives, councils also enter into commitments and obligations that give rise to liabilities.

Similar to assets, liabilities are either current (short term, usually requiring settlement within the following financial year) or non-current (due after more than one financial year).

The difference between assets and liabilities (net assets or net liabilities) represents the equity of the council. Some common features of the assets and liabilities of a council and some of the challenges in relation to the measurement and presentation of the financial values represented by these assets and liabilities are discussed below.

BALANCE SHEET		
AS AT 30 JUNE 2018		
	2018	2017
	$'000	$'000
ASSETS		
CURRENT ASSETS		
CASH AND CASH EQUIVALENTS	32,104	38,211
TRADE AND OTHER RECEIVABLES	12,807	11,167
OTHER FINANCIAL ASSETS	82,500	56,500
INVENTORIES	33	34
OTHER ASSETS	1,835	1,293
TOTAL CURRENT ASSETS	**129,279**	**107,205**
NON-CURRENT ASSETS		
TRADE AND OTHER RECEIVABLES	12	27
OTHER FINANCIAL ASSETS	4	4
PROPERTY, INFRASTRUCTURE, PLANT AND EQUIPMENT	3,554,927	3,303,521
INVESTMENT PROPERTY	9,260	8,713
INTANGIBLE ASSETS	723	739
TOTAL NON-CURRENT ASSETS	**3,564,926**	**3,313,004**
TOTAL ASSETS	**3,694,205**	**3,420,209**
LIABILITIES		
CURRENT LIABILITIES		
TRADE AND OTHER PAYABLES	21,618	21,484
TRUST FUNDS AND DEPOSITS	3,323	3,204
PROVISIONS	16,314	15,274
INTEREST-BEARING LOANS AND BORROWINGS	44,713	48,948
TOTAL NON-CURRENT LIABILITIES	**47,886**	**51,673**
TOTAL LIABILITIES	**93,376**	**95,684**
NET ASSETS	**3,600,829**	**3,324,525**
EQUITY		
ACCUMULATED SURPLUS	872,531	844,634
RESERVES	2,728,298	2,479,891
TOTAL EQUITY	**3,600,829**	**3,324,525**

ASSETS

Asset valuation – Non-current assets held by council (land, buildings infrastructure and other property, plant and equipment) are mostly valued at fair value. This requirement results in the need for several subjective judgments to be made about the assets replacement cost, obsolescence (including current condition) and remaining useful life. These judgements result in a degree of uncertainty and volatility in the valuation of these assets. Incorrect assumptions or inaccurate information could lead to significant misstatements of the reported asset values.

Heritage assets – Many councils hold assets of heritage or artistic value (such as art collections, heritage buildings or park land) that give rise to valuation challenges. Where appropriate, these can be valued on the basis of estimated market price or estimated cost to reproduce. The valuation of these items will often require the engagement of a specialist in the relevant field.

Investment assets – Councils can hold investments that provide them with a financial return to fund their activities. Investment assets can include financial investments (such as bank deposits or shares) or investment property.

LIABILITIES

Provisions and Rehabilitation costs – Councils are required to recognise, as a liability, the value of leave entitlements (annual and long service) accrued (earned but not yet taken) by existing employees. Judgements are required in relation to future salary increases, probabilities of retention and appropriate discount rates in determining these calculations. In addition, many councils are required to provide for the future costs of rehabilitating and monitoring contaminated sites, such as landfills. Given the extensive post-closure monitoring commitments it is possible for these obligations to extend beyond 30 years after the site is closed. These significant periods increase the impact of even minor adjustments to any underlying assumptions, giving rise to significant volatility in the calculation or remediation provisions.

EQUITY

Equity, Funds or Reserves – The net financial value of assets less liabilities that a council holds can be split amongst various classes of equity, and reserves. A general (or retained) reserve is the most common type of reserve. However, many councils will allocate their retained surplus to other reserve accounts for various, more specific reasons. A council adopting an accounting policy presenting some of its assets on a revalued basis will also include an asset revaluation reserve that includes the cumulative revaluation gains or losses arising on the revalued assets. It is important to note that the existence of reserves does not necessarily mean the council has the cash funds available to allocate to the reserves purpose.

ELEMENTS OF COUNCIL FINANCIAL REPORTS

STATEMENT OF CHANGES IN EQUITY
(OR STATEMENT OF CHANGES IN FUNDS OR RESERVES)

This statement provides information on changes in the funds or reserves of a council, including opening and closing balances, net surplus or deficit (profit or loss) and transfers between funds (where permitted).

STATEMENT OF CHANGES IN EQUITY				
FOR THE YEAR ENDED 30 JUNE 2018				
	TOTAL	**ACCUMULATED SURPLUS**	**REVALUATION RESERVE**	**OTHER RESERVES**
	2018	2018	2018	2018
2018	$'000	$'000	$'000	$'000
BALANCE AT THE BEGINNING OF THE YEAR	3,323,525	844,634	2,471,232	8,659
SURPLUS FOR THE YEAR	31,622	31,622	-	-
NET ASSET REVALUATION INCREMENT	244,682	-	244,682	-
TRANSFER TO OTHER RESERVES	-	(3,753	-	3,753
TRANSFERS FROM OTHER RESERVES	-	29	(29)	-
BALANCE AT THE END OF THE FINANCIAL YEAR	**3,600,829**	**872,531**	**2,715,885**	**12,412**
	TOTAL	**ACCUMULATED SURPLUS**	**REVALUATION RESERVE**	**OTHER RESERVES**
	2017	2017	2017	2017
2017	$'000	$'000	$'000	$'000
BALANCE AT THE BEGINNING OF THE YEAR	2,716,821	803,493	1,908,058	5,270
SURPLUS FOR THE YEAR	41,121	41,121	-	-
NET ASSET REVALUATION INCREMENT	566,583	-	566,583	-
TRANSFER TO OTHER RESERVES	-	(3,540)	-	3,540
TRANSFERS FROM OTHER RESERVES	-	3,560	(3,409)	(151)
BALANCE AT THE END OF THE FINANCIAL YEAR	**3,324,525**	**844,634**	**2,471,232**	**8,659**

ELEMENTS OF COUNCIL FINANCIAL REPORTS

STATEMENT OF CASH FLOWS

The statement of cash flows provides information on the cash inflows and outflows of the council, classified by different types of cash flows.
As illustrated, the statement of cash flows can include cash flows from operating activities, investing activities and financing activities.

STATEMENT OF CASH FLOWS		
FOR THE YEAR ENDED 30 JUNE 2018		
	2018	2017
	INFLOWS/ (OUTFLOWS)	INFLOWS/ (OUTFLOWS)
	$'000	$'000
CASH FLOWS FROM OPERATING ACTIVITIES		
RATES AND CHARGES	165,828	160,566
STATUTORY FEES AND FINES	13,978	12,343
USER CHARGES	15,003	13,911
GRANTS – OPERATING	17,231	12,525
GRANTS – CAPITAL	1,360	4,290
CONTRIBUTIONS MONETARY	6,449	7,831
INTEREST RECEIVED	2,406	2,903
TRUST FUNDS AND DEPOSITS TAKEN	19,815	20,428
OTHER RECEIPTS	6,197	7,123
NET GST REFUND	10,305	9,908
EMPLOYEE COSTS	(82,691)	(77,527)
MATERIALS AND SERVICES	(70,100)	(63,333)
TRUST FUNDS AND DEPOSITS REPAID	(19,696)	(20,262)
OTHER PAYMENTS	(11,703)	(11,406)
NET CASH PROVIDED BY OPERATING ACTIVITIES	**74,383**	**79,300**
CASH FLOWS FROM INVESTING ACTIVITIES		
PAYMENTS FOR PROPERTY, INFRASTRUCTURE, PLANT AND EQUIPMENT	(47,927)	(55,249)
PROCEEDS FROM SALE OF PROPERTY, INFRASTRUCTURE, PLANT AND EQUIPMENT	22	-
PAYMENTS FOR INVESTMENTS	(82,500)	(56,500)
PROCEEDS FROM SALE OF INVESTMENTS	56,500	66,500
PAYMENTS OF LOANS AND ADVANCES	15	50
NET CASH PROVIDED BY OPERATING ACTIVITIES	**(73,890)**	**(45,199)**
CASH FLOWS FROM FINANCING ACTIVITIES		
FINANCE COSTS	(2,551)	(2,735)
REPAYMENTS OF BORROWINGS	(4,049)	(3,864)
NET CASH PROVIDED BY FINANCING ACTIVITIES	**(6,600)**	**(6,599)**
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	(6,107)	27,502
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE FINANCIAL YEAR	38,211	10,709
CASH AND CASH EQUIVALENTS AT THE END OF THE FINANCIAL YEAR	**32,104**	**38,211**

Cash flows from operating activities will include cash receipts (inflows) and payments (outflows) from the day-to-day operations of the council.

Cash flows from investing activities will normally include payments and receipts on purchase and disposal of investments as well as the cash flows associated with new capital works and the purchase of other non-current assets.

Cash flows from financing activities for a council will normally include loans received and loans repaid, including the cash flows associated with any finance leases.

AUDIT OF COUNCIL FINANCIAL STATEMENTS

All local government legislation requires the financial statements of councils to be subject to an annual independent audit.

An audit will enable the auditor to obtain a reasonable level of assurance in arriving at audit conclusions that will form the basis of the auditor's opinion expressed in the audit report. It should be noted that "absolute" or "total" assurance (such as a certification that the financial statements are completely correct) cannot be achieved through an audit.

Materiality is an important concept in considering the auditor's report on the financial report. The auditor's report provides assurance as to whether the financial report is materially correct. An item (amount or disclosure) is deemed material if it would result in a user of the financial report making a decision that would not have been made if the item was correctly disclosed.

The Australian Auditing Standards (ASAs) issued by the Australian Auditing and Assurance Standards Board (AUASB) provide the framework for conducting audits in Australia. An audit performed by applying the ASAs is designed to enable the auditor to identify material inaccuracies or misstatements in the financial report and results in an opinion by the auditor on whether the financial report presents fairly or gives a true and fair view of the financial position, financial performance and cash flows (as applicable) of the entity, in all material respects. If stipulated by legislation or other requirements, the auditor may also state in the audit report whether the financial report is prepared in accordance with applicable accounting standards and legislation.

TYPES OF COUNCIL AUDIT OPINIONS AND WHAT THEY MEAN

Unmodified opinion – An unmodified auditor's report effectively states the auditor believes the financial statements present a true and fair view, and are in accordance with accounting standards and relevant legislation. This is sometimes also called an "unqualified", "clear" or a "clean" audit opinion.

Emphasis of matter and Other matter – In some circumstances, the auditor will include additional wording in the auditor's report directing users to information that in their view is fundamental to understanding the financial statements. This information is included in the financial statements, such as a note (called an "emphasis of matter" paragraph), or where the information is not included in the financial statements (called an "other matter paragraph"). It is important to note that an emphasis of matter or other matter paragraph is not a qualification, limitation or adverse conclusion.

Modified audit report, 'Qualified or Except for'' – The opinion states the financial statements are presented fairly and are in accordance with accounting standards except for the effect of a specific matter or matters. The issues are described in a separate paragraph within the report. A qualified opinion is issued when a specific part of the financial statements contains a material misstatement or adequate evidence cannot be obtained in a specific, material area, and the rest of the financial statements are found to present fairly, in accordance with accounting standards. An example where this could occur is when the auditor has a different view on the valuation of an asset than that applied by management in the financial statements, but the rest of the financial statements were found to be free of material misstatements.

Modified audit report, 'Disclaimer of opinion' – In this situation the auditor cannot reach an opinion overall on the financial statements and therefore disclaims any opinion on it. This could occur if the councils financial reporting information system is damaged and key data is lost, meaning adequate evidence is not available to support the disclosures in the financial statements.

Modified audit report, 'Adverse opinion' – In this situation, the opinion states that the auditor believes the financial statements do not present fairly, and are not in accordance with accounting standards. An adverse opinion is issued when the auditor believes misstatements are so pervasive that the financial statements do not present fairly, or are not in accordance with accounting standards.

HOW TO READ COUNCIL FINANCIAL REPORTS

There are similarities and differences in the information needs of users of council financial reports, and the information needs of users of for-profit financial reports. The following table illustrates some of the key differences and similarities. Many of these questions are those that councilors should have in mind when reviewing financial reports.

COMMON QUESTIONS ASKED BY USERS OF FOR-PROFIT FINANCIAL REPORTS	COMMON QUESTIONS ASKED BY USERS OF COUNCIL FINANCIAL REPORTS
What is the profit (or loss) made by the entity in the financial year?	How well has the council performed in meeting its objectives?
What is the financial strength of the entity?	Did the council make a deficit (loss)? How high was the surplus (profit)?
Does the entity generate a satisfactory return on my investment?	What is the financial strength of the council?
What level of dividend will be paid to shareholders?	Has the council fulfilled its commitments in terms of the Council Strategic Plan, or similar?
Does the entity have a viable and sustainable future?	How does the council's financial performance and position compare to similar sized councils?
Is this an entity I can invest in, or lend money to?	Does the council have a viable and sustainable future?
How effective is the entity's management?	How effective is the council's management?
	How did the council perform against its budget?

As noted above, there are similarities and differences in questions asked by users of the two types of financial reports. Although some of the questions can be similar, the underlying reasons for asking these questions may differ. For example, the user of a for-profit entity financial report may seek to know how well the entity is being managed in generating returns for its investors, whilst the same question may be asked in a council scenario to establish if the entity is fulfilling its objectives satisfactorily.

HOW TO READ COUNCIL FINANCIAL REPORTS

STEP 1 – UNDERSTANDING THE ENTITY

Before commencing the analysis of a council's financial report, it is important to obtain a good understanding of the entity, including its:

- Objectives, governance structure, and area of operation and activities – This information can be obtained from sources such as the Council Strategic Plan, Annual Plan, Strategic Asset Management Plan, Long-term Asset Management Plans, Long-term Financial Management and Sustainability Plans, Annual Report and other accountability documents. A positive aspect of council governance is that most of this documentation is publicly available through a council's website.
- Current challenges – councils operate in varying environments and face differing challenges. A key source of council specific information are the council meeting agendas and minutes. These documents will often provide the context necessary to understand the decisions and direction of the council and are often available on council websites.

STEP 2 – THE AUDITOR'S REPORT

As detailed in the preceding section the opinion of the auditor can provide insight into the veracity of the information presented in the financial reports. If the auditor concludes at the end of the audit engagement that the financial report presents fairly, the auditor's report will reflect this opinion. If required, the auditor may go on to state that the financial report is prepared in accordance with accounting standards and legislation (as appropriate). This is sometimes referred to as an unqualified or clean opinion. The requirement to prepare financial reports that present fairly, commonly arises from statutory requirements under each of the relevant local government acts. In addition, where required the auditor's report will be modified to inform the user of any material disagreement or uncertainty that is important in understanding the financial report.

Reading and understanding the implications of the auditor's report is a critical first step in understanding the financial report.

STEP 3 – READING THE FOUR PRIMARY STATEMENTS

Earlier sections contained a discussion of the types of financial information provided through each of the four primary statements that constitute the entities financial statements, and some of the common elements and features. The following sections consider how to assess the council's financial performance and financial position through the four primary statements.

Statement of comprehensive income

The statement of comprehensive income sets out the income earned, expenditure incurred and the net surplus or deficit for the financial period. The level of detail for income and expenditure can vary, with some entities providing more detail on the face of the statement, whilst others provide detail in the notes. The statement of comprehensive income for My Town is an example where some level of detail is provided through the line items presented for income and expenditure. In addition to the income and expenditure for the current period, the income and expenditure for the prior period is also provided to enable comparison of financial performance from the last period to the current period. Provision of comparative figures is a requirement of accounting standards. In many jurisdictions, budget information is also included in the financial statements.

When considering the surplus (or deficit) of a council it is important to be mindful of features specific to councils:

- The focus of a council is not to generate a surplus (or profit) for the benefit of its ratepayers and it is not uncommon for a council to consistently achieve small surpluses (or deficits) every year, particularly when compared to the overall revenue or expenses. This is usually termed as achieving a 'breakeven' result.
- Councils operate in a volatile environment and the financial result can be significantly impacted by issues outside the councils direct control, for example they may:
  - Receive significant grant funding in advance in a given year. This will often happen when a grant is received close to year end, with the related expenses to occur in the next year. This will result in a large surplus in one year, potentially followed by a deficit in the next, or
  - Receive a large value of contributed assets from a developer, leading to a significant surplus that is not reflective of actual operations.

Given the preceding, a significant surplus (or deficit) achieved in a particular financial year does not necessarily indicate good or bad financial performance in that year. The information should be considered in conjunction with other information in the financial report that may provide an explanation for the surplus (or deficit). In order to obtain a proper appreciation of the reason for significant surpluses (or deficits), it is important to assess the information provided in the other primary statements and notes to the financial statements.

The impacts of the preceding matters often lead councils to report, by way of note or other commentary, an 'underlying result'. While there is no universal definition of underlying result, it is typically used to remove the impacts of one-off or other events that have the potential to distort the reported result. Care should always be taken when considering underlying results, in particular it is important to ensure that users understand what adjustments have been made to the reported result and why these are seen as outside the 'normal' operations.

HOW TO READ COUNCIL FINANCIAL REPORTS

In considering the statement of comprehensive income it is useful to compare the actual results with those budgeted for, this will enable the identification of where the actual results are not consistent with what was planned by the council.

Statement of financial position

The statement of financial position provides information on the assets and liabilities of the council and the equity these assets and liabilities represent.

Some asset values are included at cost, which is based on the historical cost of the asset. Other assets are recorded at fair value, which is based on the replacement cost of the asset, adjusted for obsolescence to reflect its current condition – this is often referred to as the current replacement cost.

Current assets are assets that the council expects to recover or realise within the following financial year. Non-current assets can normally be recovered or realised over a longer period, after more than one financial year. Most non-current assets of councils are held with no intention to dispose of but to use in conducting the activities of the council. Physical assets such as property, infrastructure, plant and equipment are such assets.

Financial assets can either be current assets (such as cash held at the bank) or non-current assets (such as long-term investments held for a return). Similarly, non-financial assets can either be current (such as inventories) or non-current (such as property). Liabilities are classified similarly and are presented as current and non-current liabilities on the statement of financial position.

The statement of financial position can provide useful insights into the financial strength of a council, however significant care should be taken to ensure misunderstandings do not occur. As a significant portion of non-current assets are held to deliver council services, these are not likely to be available to fund other activities. Many councils will have a significant excess of assets over liabilities, however when adjusted for the assets that are required to be retained and maintained for the delivery of service, the balance sheet will have a far smaller excess of assets over liabilities, possibly even a deficiency.

Statement of cash flows

In contrast to the statement of comprehensive income, the statement of cash flows presents the inflows and outflows of cash from the council's various activities. Some of these cash flows will relate to income and expenditure for the year (for example grants received or salaries paid) whilst other cash flows relate to items in the statement of financial position (such as the acquisition of investments).

The cash flow statement will also provide important information regarding the level of funds expended, on new and renewed infrastructure. Given the significant asset base that a council is required to manage, this information is critical in assessing the reasonableness of the council processes for maintaining the infrastructure base.

Statement of changes in equity

The statement of changes in equity presents the retained earnings and reserves held by the council. The reserves can be presented individually in the statement of changes in equity, or alternatively a summary is presented in the statement, with further details provided in the notes. The statement shows the balances brought forward of the amount held in the reserves, the movements in and out during the year, and the balances carried forward. The movements include the surplus or deficits arising during the year and changes in the asset revaluation reserve.

It is important to note that there is no direct linkage between reserves detailed in the statement of changes in equity and the available funds (cash and investments) in the balance sheet. The simple existence of a reserve within equity provides no assurance of available cash or other funds to meet the objectives of the reserve

GLOSSARY

Accounting standards: Standards applied in preparing financial statements. In Australia, these standards are issued by the Australian Accounting Standards Board (AASB).

Accounts payable: money owed by council to its suppliers. Often referred to as creditors.

Accounts receivable: money owed to the council by its customers for goods or services provided. Can include rates receivable. Often called debtors.

Amortisation: reflects a council's use of its non-physical assets through a systematic reduction in their value over time.

Assets: Items of value which provide a future economic benefit to council. The future benefit may be achieved through the council provision of a council service (such as a road) or the ability to exchange for value (such as cash).

Assurance: The expression of a conclusion that is intended to increase the confidence of users in financial statements. The auditor's report, if unmodified, provides a reasonable level of assurance that the financial report in materially correct.

Auditor's report: The final report setting out the auditor's opinion on council's financial report.

Carrying amount: the amount at which an asset is shown in the statement of financial position after deducting accumulated depreciation.

Current assets: an asset that can be converted to cash within one year. Usually cash, short-term investments or accounts receivable.

Current liabilities: an obligation or liability that is due to be settled, or paid, within one year.

Current replacement cost: replacement cost of the asset, adjusted for obsolescence to reflect its current condition.

Deficit: The excess of expenses over income.

Depreciation: reflects a council's use of its physical assets through a systematic reduction in their value over time, usually to reflect wear and tear.

Employee entitlements: amounts owed to the employees of council for unused leave such as annual leave and long service leave.

Emphasis of matter: A paragraph included in the auditor or reviewer's report referring to a matter appropriately presented or disclosed in the financial statements, that in the auditor's judgement, is of such importance that it is fundamental to the user understanding of the financial statements.

Equity: Total assets less total liabilities.

Expense (Expenditure): the cost incurred or required for something.

Fair value: The monetary or financial value that a council could obtain on the sale or disposal of an asset in an open market scenario or, if there is no market, the cost to replace the asset in its current condition.

Historical cost: The original monetary or financial value of an asset or item acquired by a council.

Impairment: A reduction in the value of an asset when the carrying amount exceeds the recoverable amount of the asset. Usually applied to debtors to provide for some debtors not being recoverable in the future.

Liabilities: An obligation (normally to make a payment) council has to a party external to itself.

Liquidity: The ease with which assets can be converted into cash.

Material misstatement: An inaccuracy or omission in the financial statements that is significant enough to affect the decisions made by users of the financial statements.

Modified opinion: A modification by the auditor or reviewer of their report that results in a qualified opinion, adverse opinion or disclaimer of opinion, or the addition of an emphasis of matter paragraph.

Revenue (Income): An economic inflow to council.

Surplus: The excess of revenue over expenses.

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