

5 July 2024

ATT Hon Emily Suvaal MLC
Chairperson
Standing Committee on State Development
6 Macquarie Street
NSW Parliament House
Sydney NSW 2000

Dear Ms Suvaal

SUPPLEMENTARY QUESTION RESPONSES - INQUIRY INTO THE ABILITY OF LOCAL GOVERNMENTS TO FUND INFRASTRUCTURE AND SERVICES

City of Newcastle (CN) thanks The Standing Committee on State Development for their invitation to attend the hearing and give evidence for the inquiry into the ability of local governments to fund infrastructure and services. In response to your email dated 17 June 2024, CN provides the following:

TRANSCRIPT CORRECTIONS

Nil

ANSWERS TO SUPPLEMENTARY QUESTIONS

1. Your submission claims that the accounting standards are increasing in complexity and are not as valuable for council performance. Could you explain how this affects you?

The increasing complexity of accounting standards, designed for the for-profit sector, significantly impacts local councils by introducing intricate requirements that do not always align with their public service mandate. Standards such as AASB 15 (Revenue from Contracts with Customers) demand councils to adapt to frameworks tailored for profit-driven entities, leading to an increased resourcing/administrative burden and potentially misleading performance indicators.

Additionally, these standards necessitate the allocation of more resources and require the hiring of specialised staff or training of existing staff, resulting in higher operational costs. It can also be challenging for local councils to recruit or retain staff with the requisite skills and expertise.

Furthermore, the introduction of complex balance sheet items such as lease accounting, contract liabilities, contract assets and contract cost assets, fair value adjustments, along with the revaluation of infrastructure and property, adds layers of complexity to financial reporting. These requirements, while essential for transparency, do not always reflect the councils' operational effectiveness and can divert focus and resources away from core service delivery. Determining the nature of grant income (capital or operating) and complying with detailed revaluation processes further increases the workload on finance resources. Consequently, while these standards are aimed at enhancing financial reporting accuracy, they often shift the council's focus from enhancing service delivery to meeting stringent compliance obligations, potentially affecting their efficiency in serving the community.

2. You say in particular “recognition of income” in the accounting framework causes trouble - what does this mean in outcome?

The recognition of income presents significant challenges for local councils due to the complexity and ambiguity inherent in applying standards like AASB 15 and AASB 1058. One of the core issues is determining which standard applies to a given grant funding agreement, particularly when deciding between the enforceability and specificity of arrangements. AASB 15 requires councils to assess if an agreement is enforceable and sufficiently specific, which often demands a deep understanding of contract law, an area beyond typical accounting expertise. This complexity is exacerbated by the high threshold for meeting these criteria, leading to difficulties in matching income with the period in which related expenditures occur. This mismatch can result in recognising income "upfront," potentially misrepresenting the council's financial performance when expenditures are expected to span future periods.

Moreover, AASB 1058, which addresses income for not-for-profit entities, introduces further complexity with its vague criteria and the lack of a definition of "identified specifications" means that there are significant judgements to be made for each contract. The absence of industry-specific guidance and examples leaves councils with significant judgment calls, making it difficult to compare consistently across different councils. This inconsistency undermines the comparability and reliability of financial statements, complicating the assessment of financial sustainability and performance across the sector.

3. What risks do these accounting standards pose to OLG's accounting metrics?

The adoption of complex accounting standards presents significant risks to the Office of Local Government's (OLG) performance metrics. These standards require councils to exercise considerable judgment and make extensive use of estimates and assumptions, particularly in critical areas such:

- Fair values of investment properties
- Fair values of infrastructure, property, plant and equipment
- Employee benefit provisions
- Provisions
- Impairment of receivables
- Determination of whether performance obligations are sufficiently specific and whether the contract is within the scope of AASB 15 Revenue from Contracts with Customers and / or AASB 1058 Income of Not-for-Profit Entities
- Determination of the lease term, discount rate (when not implicit in the lease) and whether an arrangement contains a lease

These judgments and estimates are inherently uncertain and can lead to significant variations between projected and actual outcomes. Metrics used by the OLG, such as operating results before capital, are heavily influenced by the above accounting judgments.

Additionally, the requirement to regularly revalue infrastructure, property, plant, and equipment at fair value adds further uncertainty. While comprehensive valuations are performed at least every five years, councils must assess the carrying amounts annually to ensure they reflect current fair values. Changes in asset values can lead to adjustments that affect revaluation reserves and income statements, which may not align with actual operational performance.

As a result, the reliance on accounting metrics that are subject to high levels of judgment and estimation makes it impractical to use these metrics for reliable benchmarking and assessing financial performance and sustainability across the local government sector.

4. Do you think that the increasing complexity of these accounting standards affect the elected officials' ability to oversee the finances?

CN has a close working relationship with its elected officials' and supports their financial decision making through a thorough induction processes and monthly workshops. However, the increasing complexity of accounting standards significantly impacts the ability of elected officials' to effectively oversee the finances of local councils.

According to the OLG Councillor Induction and Professional Development Guidelines (2018), elected officials are expected to understand basic financial terminology and engage in informed discussions about financial resource allocation. However, the sophistication required to comprehend and apply accounting standards without specialised and continued training creates a gap in understanding. This gap can hinder their ability to grasp the long-term financial implications of decisions, such as those related to the balance sheet. Consequently, elected officials may struggle to evaluate the financial health and sustainability of their councils accurately, potentially leading to less informed decision-making.

Moreover, the industry's and OLG's emphasis on achieving constant surpluses complicates financial oversight further. Complex accounting rules can obscure the true financial position of a council, making it challenging for elected officials to balance the need for fiscal responsibility with strategic investments in infrastructure and services. Without a deep comprehension of these standards, elected officials might find it difficult to advocate for or justify strategic financial decisions that involve temporary small deficits but lead to long-term benefits.

5. Do you think a change in these accounting standards would better allow Councillors to understand where money is coming from, where it's going, and where it could be used more effectively?

CN is an advocate for accounting standards to include more specific guidance tailored to local government as opposed to current for-profit contexts. This would significantly reduce the extensive use of estimates and assumptions. Introducing a reporting regime specifically designed for local governments would provide clarity and relevance, making financial statements more intuitive and reflective of the councils' operational realities. This targeted approach would align financial reporting with the unique objectives and activities of local councils, facilitating better decision-making and resource allocation by Councils and the OLG. This in turn would create greater awareness and understanding for the community.

Moreover, engaging with local government and not-for-profit entities to develop these tailored standards could address specific areas where guidance is currently lacking. Such collaboration would ensure that the resulting standards are grounded in the practical needs and governance structures of these entities, rather than imposing a one-size-fits-all model. This engagement would also foster a better understanding of Council Performance, leading to financial reports that are not only compliant but also more transparent and useful for strategic planning and community service delivery.

ADDITIONAL INFORMATION

Nil.

Should you require any further information on this matter please contact _____, Executive Manager Finance Property and Performance and Deputy Chief Financial Officer _____.

Yours faithfully

^y
David Clarke
ACTING CHIEF EXECUTIVE OFFICER