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GUIDANCE PAPER – December 2016
Local Government Underlying Result Calculation

In many Australian jurisdictions councils are now required, or strongly encouraged, to report results for a number of sustainability performance indicators. There is a reasonable level of consistency across jurisdictions, particularly in relation to some measures though there are differences in methods of calculation. This is certainly the case with the underlying (operating) result ratio.

This guidance is aimed at assisting Tasmanian councils in calculating their underlying surplus/deficit and associated ratio for financial statement disclosure purposes. While it may differ from the approach taken in some other states, to enhance comparability within Tasmania, it is important that it is consistently determined.

The intent of the underlying result is to show the outcome of a council's normal or usual day to day operations. It is intended to remove extraneous factors that could create volatility and therefore make it difficult for users to understand the outcome of a council's normal operations. It is an important indicator of financial sustainability which seeks to answer the following question:

> *Can we continue the sort of revenue and expenditure patterns of recent years while* maintaining *the levels of service expected by the community?*[1]

The definition of **Underlying Surplus** in the *Local Government (Management Indicators) Order* 2014, "is …an amount that is the recurrent income (not including income received specifically for new or upgraded assets, physical resources received free of charge or other income of a capital nature) of a council for a financial year less the recurrent expenses of the council for the financial year".

Some of the key elements of the above can be defined as follows:

- Recurrent – transactions that recur and are not of a capital nature.
- New or upgraded assets – specific purpose (or tied) funding related to construction of new or enhancement of existing assets' service.
- Physical resources received free of charge – assets transferred or contributed to council for little or no compensation, examples include subdivision assets, vested assets such as those transferred from State government.

[1] SA LGA 'Financial Sustainability' Information Paper No 1 – *Financial Sustainability* - Revised January 2012

- Other income of a capital nature – all other capital funding related to non-financial assets, such as specific purpose (or tied) funding for replacement of existing assets including Roads to Recovery funding (R2R).

Income of a capital nature is defined as:

> *"Amounts received from transactions with external parties that do not form part of the council's operating business activities and are in connection with non-financial assets"*[2].

Treatment of Roads to Recovery Funding

R2R funding is designed to ensure that local government authorities do not substitute R2R funding for their own funding. It is intended to enable councils to undertake road work additional to what they could undertake using their own funds[3].

While R2R funding may recur from year to year, it is not intended to be part of council's normal operations, even though some councils may see it this way. Moreover, in the majority of cases R2R funding is used for capital works, usually the replacement of existing assets, and therefore is captured by the definition of income of a capital nature. In rare circumstances, R2R funding may be received for operational purposes.

As R2R funding is generally capital in nature, it would be excluded from the recurrent income and therefore the underlying result.

Treatment of Other Exclusions from Underlying Result

The following items would usually be excluded from **<u>recurrent revenue</u>**:

- Insurance claim or reimbursement of expenditure received as they relate to assets or operating costs previously incurred/disposed/written-off and excluded from operating expenses (eg claim payment under Natural Disaster Relief and Recovery Arrangements).
- Money received from the sale of land for unpaid rates that is not claimed by the owner of the land within 3 years of the sale.
- Donations or bequests that are subject to restrictions on the use of funds or are one-off in nature and significant in dollar terms.

The following items would be excluded from recurrent expenditure:

- Asset revaluation decrements (or reversal of previous decrements).
- Disposal/write-off of assets as a result of natural disaster or other unforeseen event (eg flood damage).
- Were clearly identifiable, additional operating costs associated with significant natural disasters or other unusual events, including fraud and fire.
- Disposal/write-off of assets for abnormal reasons (if external funding is received for the replacement of the asset then this would indicate that it is abnormal in nature).
- Payments or provision in relation to a redundancy program.
- Major impairment write-downs.

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[2] DILGP Queensland ……

[3] Programme Procedures for the Roads to Recovery Programme – June 2015

Financial statement users and preparers are reminded that no one indicator should be viewed in isolation.

No guidance can account for every situation that may arise. The overarching principle in this case is that non-recurring and capital related transactions should be excluded from the underlying result. Any other items that may need further consideration should be discussed with the council's respective audit team.