



The Local Government Industry Accounting Newsletter & Financial Management Best Practice Guide from **LG Solutions**.

LOCAL GOVERNMENT  
FINANCE PROFESSIONALS

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APRIL 2007

Hi everyone,

This month's edition of **LG "Debits & Credits"** provides some further information and justification as to why you should eliminate any pre AIFRS Asset Revaluation Reserves if you are still reporting one - prior to commencing Fair Value revaluations this year.

The "good oil" on this can be found in our **Question & Answer** section. So make sure you check your Councils 05/06 first AIFRS Financial Report and see whether you need to eliminate any Asset Revaluation Reserves!!

Our "**Did you know**" section gives you some information on a positive move by the Institute of Public Works Engineering Australia (IPWEA) in their attempts to formalise some uniformity surrounding the financial management of assets (including the question of Revaluations).

As well, we issue our 3<sup>rd</sup> **Best Practice Guide** for 2007 in this edition on **Electronic Funds Transfer (EFT) Controls**.

As we alluded to in the March edition, last month was quite busy for **LG Solutions** and saw us attend 5 LGFP groups across NSW - Northern Rivers, Riverina, Northern Metropolitan, Mitchell Group & the South Coast. We plan to do another tour around November to various LGFP Groups around NSW, so if we have not yet visited your group, just contact us and we will try & organise just such a meeting.

Other than that - happy reading & I am looking forward to catching up with as many subscribers as possible at the LGFP Conference in May!!

**Ken Crawford,**  
Editor - **LG "Debits & Credits"**

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An introduction to the IPWEA (Institute of Public Works Engineering Australia), its National Asset Management Strategy Australia (NAMS) initiative & its 8 draft position papers - as it works towards an "Australian Infrastructure Financial Management Guidelines" paper.

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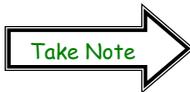
# 1. CURRENT ISSUES IN "ALL THINGS ACCOUNTING & LOCAL GOVERNMENT"

## 1.1 Dates to Remember this Month and Next for NSW Councils...

Reminders from a Financial Management and Accounting perspective:

### April Reminders:

- ☑ 60 days available (at best) until 2007/08 Management Plan has to be put on Public Exhibition - it sounds a long time, but watch it run down!!
- ☑ A reminder notice for the 4<sup>th</sup> Rates Instalment must be sent out by the 30<sup>th</sup> of April to all those ratepayers whose rates & charges are being paid by quarterly instalment - [s562 (5)].
- ☑ The March Investment Report needs to be tabled at an Ordinary Meeting of Council by the end of April.



The Responsible Accounting Officer must include in this report a certification as to **"whether or not the investments have been made in accordance with the Act, the Regulations and Council's actual Investment Policy"**.

Local Government (General) Regulation 2005 - paragraph 212

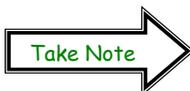
### May Reminders:

- ☑ 30 days available (at best) until 2007/08 Management Plan has to be put on Public Exhibition!!
- ☑ The Quarterly Budget Review Report to 31 March 2007 must to be tabled at a Council Meeting by the 31<sup>st</sup> May.

In relation to this statutory Quarterly Budget Review Report:



The Budget Review report must include an opinion from the Responsible Accounting Officer as to whether **"the financial position of the Council is satisfactory"** based upon the revised estimates of income and expenditure reported.



If the financial position is deemed to be unsatisfactory, then the Responsible Accounting Officer (RAO) is required to provide **"recommendations for remedial action"** within the report. Local Government (General) Regulation 2005 - paragraph 203



Refer to our January Q&A section relating to the RAO's required "statement" on Councils financial position to be included in the Councils Quarterly Budget Review.

As per our answer, we think you should start narrowing the scope of what you are saying is "satisfactory" regarding Councils financial position given the new focus on Long Term "financial sustainability"!!

Perhaps limit the statement to addressing only Councils projected Short Term Liquidity position or level of Available Working Capital!!

### A General Reminder...

#### Is your Council Applying for a Special Rate Increase!?

Remember that completed Applications (with the exception of the actual feedback from the draft management plan consultation process) to vary Councils General Income for 07/08 beyond the Ministerial annual increase should be finalised and submitted to the Department **within 2 weeks of the Ministers announcement as to the value of the rate-pegging percentage for 2007/08.**

NB: A guide to assist councils in this process is available in the publications section of the department's website, titled 'Special Variation Guidelines'.

<http://www.dlg.nsw.gov.au/dlg/dlghome/documents/Information/06-68%20Guidelines.pdf>

Guidelines to complete applications under both section 508(2) and section 508A have been developed in accordance with section 23A of the Local Government Act 1993. These guidelines are also part of the 'Special Variation Guidelines' document.

Applications must be completed in accordance with this document.

## 1.2 NSW DLG Circulars to Note

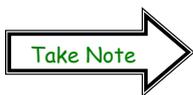
All is quiet this month regarding NSW DLG issued circulars that are of interest to NSW Local Government Finance Practitioners...which leaves you plenty of time to concentrate on Draft Management Plans etc!! ☺

### 1.3 Latest news from the FRC.

The March meeting of the Financial Reporting Council of Australia set in motion a requirement for Audit reports to specifically state whether an entities YE General Purpose Financial Report complies with IFRS's!!

In particular, the FRC was "of the view that promoting the international recognition of Australia's IFRS adoption is in the public interest and that the inclusion of a statement of IFRS compliance in the auditor's report would further the recognition of Australia's IFRS adoption by helping to address the current lack of prominence given to IFRS compliance in the financial reports of Australian companies."

It is now in the hands of the AuASB (Auditing and Assurance Standards Board) to implement the specifics & time frame for such an opinion by auditors within the Audit Report!



Generally speaking, should such a statement be required also within Local Government Audit Opinions, we would expect most auditors to indicate that Councils YE Financial Statements do not comply with IFRS - due in part to the AASB specifically excluding not-for-profit entities from applying certain standards including Grant Accounting, Related Party Disclosures, and components of AASB 116 Property, Plant & Equipment etc.

### 1.4 Latest news from the AASB.

The AASB's meeting in March touched on a couple of Local Government issues;

- ☑ The Exposure Draft (ED) titled "Proposals Arising from the Short-term Review of the Requirements of **AAS 27**, **AAS 29** and **AAS 31**" is closer to being released!!

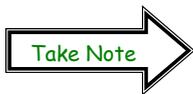
The result should see AAS 27 disappearing (perhaps for the 07/08 year !!??) with most of the specific AAS 27 requirements already being covered within the existing AIFRS suite of standards with supplementation from (a) two new topic based standards on Land Under Roads & Reporting by Functions and (b) an expansion of AASB 1004 on Contributions.

We will await the ED and comment further and in more detail then!!

- ☑ There are moves afoot for the issuance of a scaled down suite of AIFRS standards for Small & Medium Sized Entities (SME's).

This move and these "scaled down" SME Standards will not only be applicable in the for-profit Corporate world but also in the not-for-profit sector as well. At this

stage the AASB is proposing a size test to determine which entities use the AIFRS's and which use the SME AIFRS's.



I wouldn't anticipate that we will see a two tier system within Local Government, where some Councils (based on size) report their YE Financial Accounts using the "full strength" AIFRS's whilst smaller Councils utilise the scaled down SME versions!!

One would assume the DLG will mandate ALL Councils (irrespective of size) will be required to prepare their YE Accounts using the AIFRS standards (and not the SME standards) for the sake of comparability and uniformity of accounting and reporting.

We'll keep you posted further when an Exposure Draft is put out for comment!!

- ☑ The AASB released **Exposure Draft ED 154**: "Proposed Amendments to AASB 102 - Inventories held for distribution by Not-For-Profit Entities" in March.

At present, where a not-for-profit entity holds inventories expressly for service delivery (as opposed to for sale at a profit), entities must value the inventories at the lower of Cost & Current Replacement Cost.

The draft ED proposes that such inventories will now be valued only at cost subject to any loss in service potential as a result of obsolescence in the inventories not being able to provide the utility required.

At this stage, we don't think this will have too many impacts for Councils.

The draft ED amendments to **AASB 102** will if adopted be applicable for the 07/08 year.

- ☑ Accounting For Grants

We alluded in a previous edition of LG "Debits & Credits" on the AASB's intention to jointly work with the NZ FRSB to develop a Standard on "Revenue from non-exchange transactions" (ie. Accounting for Taxes & GRANTS).

The AASB has proposed that an Exposure Draft should "draw on the best features of **IPSAS 23 Revenue from Non-Exchange Transactions (Taxes and Transfers)**, **IAS 20 Accounting for Government Grants and Disclosure of Government Assistance** and other Standards (domestic and foreign)."

What is interesting from the February AASB Board minutes is that AASB staff anticipate a "project" completion date for this of **June 2010!!!**

With **AAS 27** disappearing off our radar sometime soon, a 2010 deadline seems just a little too far away - which was also the view of the AASB Board who recommended that staff look at bringing forward this estimated finalisation date!!

Still - maybe the transition from AAS 27's Income Accounting of Grants to the IPSASB's Liability Accounting will not be just around the corner as I had hoped!!

### 1.5 Other Issues.....Latest news from the ATO - FBT amendment

The ATO has made amendments to the FBT Reporting Rules for the FBT Tax Year commencing 1 April 2007 in relation to Motor Vehicles.

Generally, the fringe benefit reporting rules in the Fringe Benefits Tax Assessment Act require an employer to report the grossed-up taxable value of an employee's fringe benefits where the value of fringe benefits exceeds \$2,000.

However, the recent amendment now provides a "fringe benefits reporting exclusion" for the pooled or shared private use by employees of their employer's cars. A pooled or shared car is a car that is provided by an employer for the private use of two or more employees.

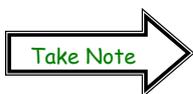
According to the explanatory statement released with the amendment, "the reporting exclusion for pooled or shared cars would result in employees who have pooled or shared private use of their employer's cars not having the grossed-up taxable value of such fringe benefits reported on their payment summaries. This may increase their access to certain Government benefits and reduce their liability to income-related surcharges and obligations."

The Explanatory Amendment that was issued with the Legislative Change can be found at:

[http://www.frli.gov.au/ComLaw/Legislation/LegislativeInstrument1.nsf/0/CDE2336FBED06F3FCA2572A6008107C6/\\$file/F2007L00664.pdf](http://www.frli.gov.au/ComLaw/Legislation/LegislativeInstrument1.nsf/0/CDE2336FBED06F3FCA2572A6008107C6/$file/F2007L00664.pdf)

while the home page for the actual legislative change can be found at:

<http://www.frli.gov.au/ComLaw/Legislation/LegislativeInstrument1.nsf/all/whatsnew/4B32F796D18E3D87CA25729E00015FD6?OpenDocument&VIEWCAT=item&COUNT=999&START=1>



The amendment does not mean that FBT is no longer applicable to pooled cars, just that there is no requirement to attach (and report) the FBT to individual employees and report it on their Year End PAYG summaries!!

## 1.6 Latest news from the IASB.

Some interesting long term "watch this space" developments at the International level include the following tentative discussions by the IASB:

- ☑ Requiring the movement in Balance Sheet line items between years to be reconciled and disclosed in the YE Accounts,
- ☑ The elimination of the term "Cash Equivalents", meaning that the Cash Flow Statement will only reflect changes in Cash!!
- ☑ The IASB is progressing its Lease Accounting review along a "right of use" approach.

Under this approach, "the lessee recognises its right to use the leased item and an obligation to pay for that item...while the lessor recognises as an asset its right to receive payments from the lessee and its residual interest in the leased item at the end of the lease."

In other words, ALL leases will be recognised on the Balance Sheet, regardless of their being Operating or Financial in nature.

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## 2. This Months AIFRS Review

This month is a quiet one regarding any AIFRS reviews.

The May edition of LG "Debits & Credits" will see us review **AASB 108 - Accounting Policies, Changes in Accounting Estimates & Errors**, with an eye to reminding everyone about the requirements of "**Retrospective Restatement**" and "**Retrospective Application**" under an AIFRS environment and in particular the implications for Councils prior year 05/06 comparatives.

As well, we will also be putting together a recap of some AIFRS YE accounting & reporting issues in our June Edition to get everyone focused on their preparation of Councils 06/07 General Purpose Financial Reports - which will be of course the second year of accounting and reporting under AIFRS!!

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### 3. BEST PRACTICE GUIDE

#### The Electronic Funds Transfer of Creditors - a perspective on critical internal controls.

##### (i) Introduction

Electronic Funds Transfers (EFT) in relation to the payment of Creditors & Suppliers has the potential to increase the efficiency with which Councils go about the payment process for its Creditors & Suppliers as well as additional spin off benefits such as reduced effort in performing the Bank Reconciliation.

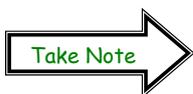
A short list of positives from implementing an EFT payment process include:

- an efficient payment process that excludes the signing & mailing of numerous cheques,
- a greater management relating to the timing of Councils cash outflows, leading to the lower risk (& cost) of incurring overdraft interest and loss of interest on investment funds, and
- efficiencies in the Bank Reconciliation process by matching and managing a smaller number of bank debits and unrepresented cheques.



**At the same time however, the use of EFT transfers creates an unparalleled potential for the inappropriate theft of cash at unprecedented levels!!**

Accordingly, it would be not be an understatement to declare that the use of EFT transfers requires an excellent and well thought out "bundle" of Internal Controls to minimise the increased risk potential that an EFT transfer process attracts.



**When was the last time you did a comprehensive review of your Councils EFT transfer procedures & internal controls!?**

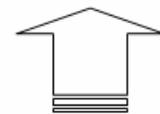
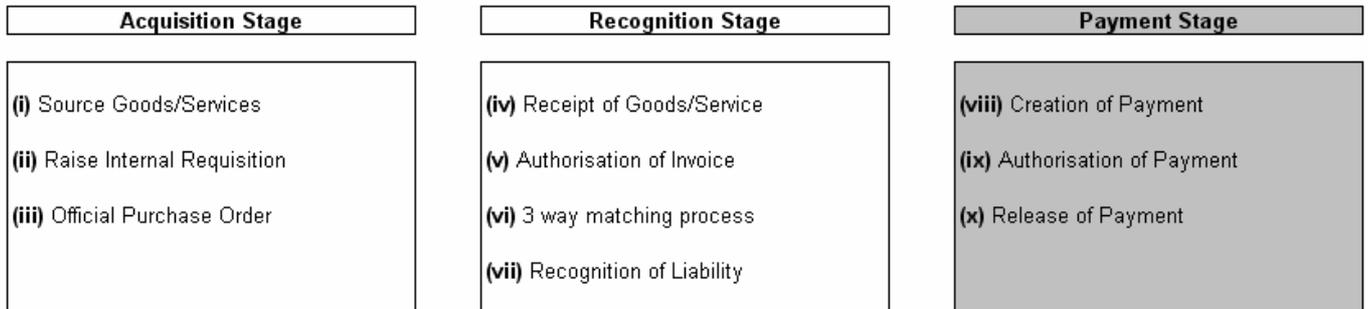
**Regardless of your answer (and we hope your response was "within the last two years"), there is no time like the present to commence a review!! 😊**

The direct experience of **LG Solutions** regarding the payment method of Councils in paying their newsletter subscription payments would tend to indicate that 20% of Councils still undertake the payment of creditors by way of cheque.

So whether you are a Council that is contemplating the use of EFT transfers for Creditors & Suppliers, or already utilise an EFT procedure, we believe the following BPG will be relevant and may prompt you into doing a review of your current or future procedures, processes & controls!

**(ii) The Acquisition and Payment stages relating to Creditors & Suppliers:**

The EFT payment procedure is the end process in the acquisition of goods & services (relevant to Councils day to day operations) from thirds parties. Generally speaking, this process represents up to three distinct stages:



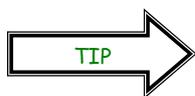
The subject of this months BPG!!!

**(iii) Critical Control Issues:**

The two primary risks relating to the **payment** of creditors & suppliers by way of EFT is (i) the transfer of unapproved (or inappropriate) payments and (ii) the transfer of approved payments but to incorrect (ie. modified) bank accounts.

**These two EFT risks therefore form the core of this Best Practice Guide on EFT!!**

Accordingly, we have tried to list down the issues and controls that should be considered to minimise these risks.



**Why not take the time to review for each control point (we have listed below) how your Council currently approaches & minimises the risk issues relating to EFT payments!?**

**(i) Controls relating to the transfer of unapproved / unauthorised amounts**

**IC1: Appropriate Paperwork**

Council officers charged with the responsibility of actually performing the EFT transfer using Councils EFT Banking Software should have appropriate access to the original creditor paperwork.

A/P Invoices relating to any one EFT transfer should be bundled up together and have as a front cover a listing from the A/P system of the created EFT File (which can be tied in with each approved invoice).

These invoices & A/P EFT Listing can (and should) be reviewed and verified to ensure all have the necessary authorisation from the ordering officers and appear to be legitimate invoices relating to Council services.

As well, the A/P EFT listing should agree in terms of the number of payments and gross value of payments to the EFT file ready for authorisation and transfer within the EFT Banking Software.

### **IC2: Certification of the actual A/P Listing and EFT File transferred**

Following on from IC1 above;

- (i) the actual A/P EFT file printout should be signed by the relevant employee who created the EFT transfer file from the A/P system (invariably a Creditors Officer) and should be certified that the A/P EFT Listing agrees to legitimate and duly authorised Creditor Invoices.

NB. These words & certification should be listed on the A/P EFT list upon which the signature is given.

- (ii) The actual Banking Software EFT Listing (which indicates the actual payments that were transferred) should be signed by the employees that authorised that actual EFT transfer, certifying that the EFT file **(a)** agreed to the total number of transactions and **(b)** the total value of transactions as per the sighted (and duly signed) A/P listing and that they are satisfied that each EFT transfer could be attributed to a duly authorised invoice.

### **IC3: Controls surrounding the actual Banking EFT Software**

Appropriate controls should be in place relating to the set up, modification and authorisation requirements relating to Councils actual Banking EFT software used to actually make the transfers.

Important controls include:

- Having a Banking EFT Software System Administrator who is outside the Finance area function & controls (i) setting up new users & (ii) configuring the software & parameters and (iii) making any modifications as required,

- Ensuring Users really keep their passwords Secure and confidential
- Requiring at least 2 Users to authorise an EFT transfer
- Having passwords automatically elapse after a certain period (say 90 days)
- The specific exclusion of both Accounts Payable staff and Bank Reconciliation staff from the EFT transfer process.

**(ii) Controls relating to the transfer of payments to inappropriate bank a/c's**

**IC4: Creditor Bank Account Details on the A/P System**

Councils need to protect individual Creditor Bank Account Details by having controls over **(a)** who can enter the bank details of new creditors and **(b)** who can modify these details later on and **(c)** what source documentation is required in either event.

- ☑ Ideally, our suggestion is that someone outside of the Accounts Payable area takes on the function of adding and modifying Bank Account Details.

It goes without saying them that there should appropriate security within the A/P system which regulates access to being able to create and modify specific Creditor Bank Details (in particular to deny access to A/P staff).

A "fall back" control in this regard could be the daily review of ALL Creditor Bank Account creations or modifications thru some sort of Maintenance Report that is reviewed by an independent person and confirmed to the required original paperwork.

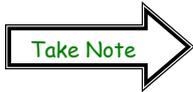
- ☑ The source documentation for new Creditor bank account details and modification details should involve asking the creditor to supply a letter (or signed Council pro forma) accompanied by either an official bank deposit slip or cancelled cheque which details the Bank Account Name, BSB & Bank Account Number.

With the ease at which documents /letterheads etc can be printed, we believe the request for a Bank Deposit Slip of Cancelled Cheque provides a level of security in relation to the legitimacy of Bank Account Details for a Creditor.

- ☑ The required notification details of Creditor Bank Details (both the initial paperwork and any amendments) should be filed in hard copy (by Creditor) and available for cross reference and verification at any time.

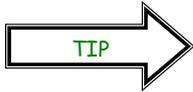
**IC5: Creditor Bank Account Details on the A/P created EFT file**

Councils also need to protect individual Creditor Bank Account Details by having adequate control over the actual EFT File subsequent to it being created by the A/P system and while it is waiting for the actual physical transfer phase.



One of the **BIG** risks with EFT transfers is the ability to access & modify the A/P transfer data (eg. bank account & amounts) outside of the Accounts Payable Sub System Internal Controls.

You will be surprised how easily it can be to access an EFT file outside the A/P process and to modify details prior to its uplift & transfer within the EFT Banking Software.



You should check how accessible the Accounts Payable EFT file is and how available to modification it is after it has been produced by the A/P system and before it has been actually transferred!!

To do this, follow how the EFT file from its creation by the A/P system up to when it gets uplifted into the Banking Software.

Is it by way of a portable storage device where the file is transported from one PC to another (not advisable!!) or is it by way of a Specific Folder on the Intranet (hopefully this folder is security protected to allow only certain users to access it).

**Comment on IC4 & IC5:**

There is an inherent safeguard in having the A/P staff specifically excluded from creating creditor bank details, modifying them and in specifically ensuring they are unable to access the A/P created EFT file prior to uplift & transfer within the EFT Banking Software.

If legitimate Creditor payments have been diverted to other parties by modification of the EFT file Bank Account Details (either within A/P or by modifying the EFT file before or during the transfer stage), then the Creditor will eventually follow up the non payment with Councils Creditors staff which should lead to uncovering the modification!!

**(iii) General Controls**

**IC6: Segregation of Duties**

The old "catch phrase" of Segregation of Duties is no less important than in setting up the Internal Controls for the EFT process.

We recommend that (i) the Bank Reconciliation officer has no involvement whatsoever with operating the Banking EFT software, (ii) the A/P staff have neither any involvement whatsoever with operating the Banking EFT software or with creating or modifying individual Creditor Banking Details and (iii) that the Investment Officer not be a user within the Banking EFT software.

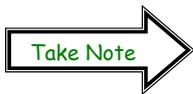
**IC7: Appropriate Audit Trails**

For each actual EFT Bulk Transfer, (i) the Actual authorised Invoices, (ii) the actual A/P created Listing (certified by the A/P staff that appropriate authorisation of each invoice has been received) and (iii) the EFT Banking Software's actual listing of the transfer details (certified by both transferors that the quantity & dollar amount of the EFT file agreed to the A/P report and that the Invoices were all sighted and appeared reasonable) should all be filed together in date order (or any numerical sequence order) for future access, audit &/or review.

**IC8: Written Guidelines for Banking Software EFT transferors**

Ensure Council has clear guidelines in place for those people involved in the actual EFT transfer of each A/P created file.

This would include what they must check, what they must print out and what they must certify as well as ensuring that they are aware of the confidential nature of their passwords at all times.



**Do you know someone else's EFT Banking Software password right now? If so, then a fundamental Internal Control has already failed!!**

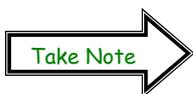
These guidelines should be signed by each staff member who will undertake effecting transfers as acknowledgement that they are aware of the control procedures in place.

**IC9: Payroll & Investments**

The Internal Controls listed above for the EFT transfer of Creditors & Suppliers should also be applicable to (i) the payroll EFT file and (ii) the purchase of Investments.

As well, NO EFT transfers for Payroll transactions or the purchase of Investments should be permitted outside of the payroll system or A/P system respectively.

ALL EFT's (and EFT transfer files) should be originated within the sub system and then transferred...not the reverse situation of doing the transfer first and then recording the Payroll or A/P transaction afterwards!!!



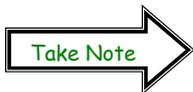
**How does Council effect the transfer of funds for the purchase of Investments!?!?**

Do you currently have sufficient evidence relating to the Bank Account details of the Broker, Intermediary or Third Party from whom you are purchasing the Investment and transferring funds to?

Again, the same procedures (as detailed above) for the maintenance and modification of the Bank Account details within the A/P system should be strictly adhered to!!

Under this scenario, each Investment should firstly be accounted for in the A/P system, with the A/P system generating the EFT Transfer File based upon already kept Bank Account Details.

This way, the normal controls, checks and balances are being followed...after all the purchase of an Investment is just the payment of a Creditor!!!

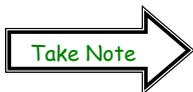


Why should you (or a designated EFT transferor) be satisfied with Bank Account details supplied on a Fax that requires URGENT PAYMENT!?

#### IC10: Plan for Holiday Periods

Ensure that appropriate procedures are in place for major leave periods such as Xmas & School Holidays.

In other words, the same Internal Controls, Checks & Balances that are in place year round should still be in place when there are staff shortages etc!!! ie. the provision for contingency arrangements that still reflect required control levels, and not ad hoc and deficient procedures...such as "here's my password in case you need to do any EFT's while I'm away!!!"



With Xmas/New Year over and high staff absences, did your EFT payment process still have adequate Controls in place!?

#### IC11: EFT Software Reports

Hopefully your Bank EFT Software can provide an Automatic Numerical Sequence for each authorised bulk EFT transfer!?

If so, then this is how the each EFT bulk Transfer (and associated A/P paperwork) should be filed away - in EFT Banking Software numerical order (otherwise date order should be used).

**IC12: The Bank Reconciliation Process**

Under an EFT payment system regime, the Bank Reconciliation should be reviewed (ie. performed) on a daily basis - in particular the review & reconciliation of EFT transfers to the A/P System (or as posted from the A/P system to the General Ledger Bank Account).

This is to ensure that any unexplained or unusual EFT transfers are investigated early on!!!

This could be as simple as the Employee who performs the Bank Reconciliation reviewing the previous days bank statements for EFT transfers and verifying that the appropriate (and duly authorised) paperwork has been filed and backs up each transfer - it does not necessarily require a full blown balanced bank reconciliation process...just a **"monitoring and verification"** process!!

Of course...this Internal Control is only as good as the segregation of duties, whereby the Bank Reconciliation officer is neither able to nor does not take part in any EFT transfers.

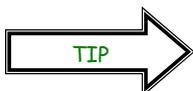
**IC13: Transfer Limits**

Why not consider having automatic limits (either within the Banking EFT Software for Users or for the System as a whole) or with the Bank specifically which controls the dollar value of any EFT transfers.

This way any large EFT Transfers would require either additional user authorisation or specific liaison with the bank prior to processing.

**IC14: Regular Reviews of the Internal Control Procedures**

We would advocate that it is always prudent to review the nature, level and adherence to the Internal Controls set up at your Council on a regular and periodic basis - at least once every 2 years if not sooner!!



**In terms of testing each Internal Control etc, don't just ask people questions etc - actually get in there and do some physical testing (incl. some dummy tests, transactions & attempted modifications) to make sure people (and logons) cannot do certain activities etc and that EFT files are safe from modification outside the A/P system!!**

**(iv) Conclusions**

There is always one thing to remember about **internal controls** - they always appear to be "over the top", unadministerable or unworkable until something goes drastically wrong!! At that point hindsight generally permits a different view such that the controls were not only necessary but anything but "over the top", unadministerable or unworkable!!

Your job as Councils Finance Professional is to make those decisions as to the level and breadth of internal controls surrounding the EFT transfer process that should be in place, and which ensures that with the wisdom & clarity of hindsight, Councils procedures & controls were as good as should have been expected in order to manage the risks!!

Keep in mind that the EFT payment process provides the potential for large value frauds to occur with an immediacy of results for the perpetrator & a large degree of anonymity in perpetrating the fraud. Accordingly strong & timely procedures along with the continual review of internal controls are a **MUST!!** There is certainly no room to be lax in the enforcement of controls in relation to EFT transfers!!

While this Best Practice guide cannot possibly list all the necessary Internal Controls applicable to the EFT payment process, hopefully, it prompts you to go some way in asking questions about your current procedures and determine whether they protect Council from the material risks that are inherent in any EFT transfer system.

---oOo---

Six Best Practice Guides (BPG's) are incorporated into each year's newsletter.

**Potential future BPG's being investigated include:**

- Internal Plant Hire considerations including accounting & reporting issues.
- Council's Purchasing Policy...what's in them and why have them!
- Section 94 Reporting Obligations.
- Using Third Party Contractors - Control Issues you should consider.
- Local Government Debt Levels, Debt Management and Debt Decisions.

**As always, we are keen to research and provide BPG's which are of relevance to users...so if you have any specific Financial Management or Accounting topics that you see as important for the Industry let us know by email and we will do our best to try and incorporate it into the 2007 or 2008 year series!**

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## 4. THIS EDITION'S QUESTION & ANSWER

### Question

In last months "Top 10" issues on Asset Revaluation, you advocated that all AGAAP Asset Revaluation Reserves in place before 1/7/05 (ie. before AIFRS) should have been (and still should be) written off during Councils transition to AIFRS, and that no amounts should have been disclosed as at 30/6/06 within Equity as an Asset Revaluation Reserve balance.

Can you explain this a bit more and provide justification for its removal!

### Answer

The Asset Revaluation Reserve under the Fair Value method of accounting for Infrastructure, Property, Plant & Equipment now becomes an all important source of information because it dictates how future Asset Revaluations are to be accounted for!!

The main reason for this is that the accounting entries for future revaluations is based upon (i) how an entity has accounted for past revaluations and (ii) the value of any Asset Revaluation Reserve that is sitting in Equity for each class of asset.

Refer to page 22 for a further "Ready Reckoner" that displays the required accounting entries to the either the Income Statement or the Asset Revaluation Reserve - depending on (i) the value in the Reserve and (ii) an entities past accounting revaluation entries.

Because of the level of importance as to what constitutes the value of the Asset Revaluation Reserve and what previous amounts have been written of (or written on) the Income Statement, which means (as discussed in last months article) maintaining reconciliations of both each ARR class within equity and each asset class posting that has occurred to the Income Statement, it is best to start afresh!!

As well, Councils as far back as 01/02 (under their transition to AASB 1041 - Revaluation of Non Current Assets) adopted "Deemed Cost" for their assets and also adopted "deemed cost" during the transition to AIFRS in 05/06 under AASB 116, and hence any Asset Revaluation Reserves up to either of these points in time became irrelevant!!

### Some justification for eliminating your pre AIFRS Asset Revaluation Reserves:

As far back as April 2006, LG Solutions advocated Councils eliminate their pre AIFRS Asset Revaluation Reserves back to Accumulated Surplus (on transition to AIFRS) and start afresh!!

Since that April Edition, the ICAA through its Accounting and Technical newsletter has published 2 Q&A's on the subject which we have attached below.

Both ICAA answers tend to back up our sentiments on an entity's ARR only relating to AIFRS revaluations:

**1. Asset revaluation reserves** (as reported in the May 2006 edition of Charter, the ICAA's magazine)

**Q:** On transition to AIFRS, what happens to an existing asset revaluation reserve when the assets to which it relates are now valued at deemed cost in accordance with the exemptions contained in AASB 1?

**A:** The standards are silent on this issue.

Some practitioners like to clear out the balance on the revaluation reserve and transfer it to retained profits or to a capital profits or other similar reserve however there are no requirements to do so.

**2. Asset Revaluation Reserves** (as reported in Sept 2005 of Charter, the ICAA's magazine)

**Q:** If we choose to deem property, plant & equipment previously measured at fair value to be cost on transition to AIFRS, what should be done with the asset revaluation reserve balance in relation to those assets?

**A:** AASB 1 is silent on what to do with the revaluation reserve, but since the asset is going to be treated as an asset at cost from then on, the associated revaluation reserve will not be available for absorbing decrements. In other words, it loses the attributes of being an asset revaluation reserve. You should also consider whether a deferred tax liability should be recognised on transition as the assets are measured at deemed cost, not actual cost.

All in all - there is no mandate for any pre AGAAP Asset Revaluation Reserve to remain as a separate line item in Equity, especially when "deemed cost" was generally adopted by nearly all Councils (i) on transition to AIFRS) but also (ii) as far back as the 01/02 Financial Year Reports where under AASB 1041 most Councils reverted to "Deemed Cost".

**What to do now:**

If your Council is still reporting an Asset Revaluation Reserve (that came about pre AIFRS), we advocate that you reverse it.

This requires a simple entry:

**Dr. Asset Revaluation Reserve**  
**Cr. Accumulated Surplus / Retained Earnings**

As well, because you reported it in your first AIFRS set of accounts, but now want to get rid of it, you should also eliminate the ARR when you disclose the comparative 05/06 Balance Sheet I the year 06/07 GPFR. This can be done by classifying the disclosure of the (AGAAP) Asset Revaluation Reserve as an "error", with an appropriate disclosure in the Notes within the 06/07 Accounts.

This way, you start AIFRS with a clean slate in the Asset Revaluation Reserves so that only those revaluations made under an AIFRS regime will make up the balance of the Asset Revaluation Reserves and therefore dictate future fair value revaluation accounting entries.

---oOo---

Don't forget - next months Q & A could be yours!!!

So if you have a general question on Local Government Accounting, Finance, Internal Controls or Reporting then e-mail your Question to us at [newsletter@lgsolutions.net.au](mailto:newsletter@lgsolutions.net.au).

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Accounting Entry  
Ready Reckoner  
for the Revaluation of  
Assets within  
Local Government

When the...

...carrying value of an  
Asset Class Increases

and

(i) there is no ARR, &  
(ii) there has been a NET "life to date" prior period loss booked to the P&L

**1 Dr. Asset**  
**Cr. Income Statement**  
--> to the value of the NET "life to date" loss booked to the P&L  
then  
**2 Dr. Asset**  
**Cr. Asset Revaluation Reserve**  
--> to the value of any excess between the Increase in asset value & the NET "life to date" loss booked to the P&L

and

(i) there is no ARR, &  
(ii) there is NO NET "life to date" prior period loss booked to the P&L

**1 Dr. Asset**  
**Cr. Asset Revaluation Reserve**  
--> for the value of the increase in the asset classes value

and

(i) there is an ARR.

**1 Dr. Asset**  
**Cr. Asset Revaluation Reserve**  
--> for the value of the increase in the asset classes value

...carrying value of an  
Asset Class Decreases

**1 Dr. Income Statement**  
**Cr. Asset**  
--> for the full value of the decrease in the asset classes value

**1 Dr. Income Statement**  
**Cr. Asset**  
--> for the full value of the decrease in the asset classes value

**1 Dr. Asset Revaluation Reserve**  
**Cr. Asset**  
--> for as much of the value of the decrease in the asset classes value as is sitting in the Asset Revaluation Reserve  
then  
**2 Dr. Income Statement**  
**Cr. Asset**  
--> for the value of any excess between the Decrease in asset value & the value of the Asset Revaluation Reserve for the respective asset class

## 5. DID YOU KNOW...

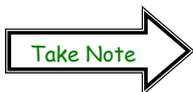
The IPWEA (Institute of Public Works Engineering Australia) through its **National Asset Management Strategy Australia (NAMS)** initiative has released 8 draft position papers as it works towards an "Australian Infrastructure Financial Management Guidelines" paper.

The 8 draft position papers cover off on the following aspects of Asset Management:

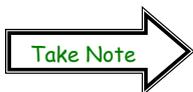
- ☑ Position Paper 1 :       **Asset Consumption vs. Asset Renewal**
- ☑ Position Paper 2 :       **Sustainability in Service Provision**
- ☑ Position Paper 3 :       **Performance Measures**
- ☑ Position Paper 4 :       **Recognition of an Asset**
- ☑ Position Paper 5 :       **Capitalisation Policies**
- ☑ Position Paper 6 :       **Revaluation**
- ☑ Position Paper 7 :       **Determining Remaining and Useful Life**
- ☑ Position Paper 8 :       **Long Term Financial Planning**

Given the context of commencing Fair Valuation Accounting within NSW Local Government, they are well worth reading!

Readers can find all the position papers at: <http://www.ipwea.org.au/nams/> (look for the various position paper links about half way down the whole page).



At this stage, there does not appear to be any finalisation of the papers or a national resolution on any standards - but it certainly gives some clues as to where the Industry as a whole is heading in order to ensure uniformity of application of accounting and managing Public Sector (and Local Government) Asset



In particular, we have reviewed NAMS Position Paper #6 on "Revaluation" given the current industry uncertainty and debate relating to "greenfields" versus "brownfields" as the basis of revaluing Infrastructure Assets.

Interestingly, the "Revaluation" position paper (at the recommendations section) initially recommended "greenfields" as the basis for determining asset revaluations, but have subsequently revised that recommendation and gone for a mixed model - ie. both "greenfields" & "brownfields".

The recommendation suggests that until an asset has in fact been replaced, that it be fair value measured on the basis of a "greenfields" valuation, WHILST once an asset has actually been

replaced, future fair valuations should be based upon a "brownfields" basis.

This would mean that Councils would have some assets under a "greenfields" Fair Valuation and some at "brownfields" Fair Valuation.

While your author needs some time "to sleep" on this proposed "mixed model" fair valuation recommendation, I certainly think it has merits!!

After all, if Local Government constantly value things at "greenfields", the issue arises as to what will happen when we actually do replace an asset and it costs more to replace [because we have to rip everything up in the process to get at the asset (eg. the pipe under the ground)].

If we have to value this asset using a "greenfields" basis 3 years after its replacement, then quite likely the "greenfields" cost will be cheaper and Council would have to write off the balance to the P&L which seems crazy!!!!

Under a "brownfields" fair valuation for a replaced asset, the fair value should be generally equivalent to what it actually cost to replace the asset 3 years ago and so there would be no need to make any large one off write offs just based on valuation alone!!!

NB. Our above discussion is based on the assumption that the replacement of a pipe under an existing road would be more expensive than the cost under a "greenfields" basis since the uplifting of the road would be ignored under a "greenfields" basis as it would be assumed not to be there!!

Of course, these draft discussion papers, the debate on what basis Councils should attempt to Fair Value their assets (ie. greenfields vs. brownfields) and the lack of direction to date at the NSW Local Government Level towards setting some uniform ground rules is hopefully something that can be addressed at an Industry level before 30 June 2007 and the fair valuation of Councils Water & Sewerage Assets!!

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## 6. EXISTING & FUTURE PRODUCTS

### THINKING ABOUT YOUR 06/07 YEAR END FINANCIAL REPORTS TEMPLATE!?

**LG Solutions** are now in our third year of providing a YE Template for NSW Local Governments.

#### Comments from Last Years users included:

- ☑ "In past years we would spend days on finalising the statements where, with your spreadsheets, we completed them in a couple of hours (with disruptions). It was not my doing but the templates you provided. JOB WELL DONE"
- ☑ "Nearly fell off the chair when Cash Flow balanced first up. Caused many grey hairs in past years. Thanks Again."
- ☑ "The templates were excellent especially once I was down to final changes - the checklists made all the difference."
- ☑ "The templates were fantastic - I can't imagine doing our accounts without them now!"
- ☑ "The cash flow worksheets were great too, a big help." "So thanks again...the Templates were brilliant."
- ☑ "I believe ours were the only LG Solutions accounts our auditors audited. They commented that they were much easier to audit. All good."

#### Our YE Templates come with three Options:

- (i) STAND ALONE,
- (ii) CUSTOMISED + PRIOR YEAR COMPARATIVES ALREADY INCLUDED, &
- (iii) BEFORE & AFTER AUDIT REVIEWS & FINAL FORMATTING.

#### To find out more:

Just drop us an email at [YE\\_Templates@lgsolutions.net.au](mailto:YE_Templates@lgsolutions.net.au) or [ken@lgsolutions.net.au](mailto:ken@lgsolutions.net.au)

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## 7. Miscellaneous Items

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- Access to appropriate professional development and training.

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### 7.2 Bibliography

#### Material Reviewed for this Publication:

Nil

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