

ITEM NO. 10

FILE NO: PSC2010-03190

REMOVAL OF BUSINESS UNITS FROM COUNCIL'S ANNUAL FINANCIAL STATEMENTS

REPORT OF: TIM HAZELL – FINANCIAL SERVICES SECTION MANAGER

GROUP: CORPORATE SERVICES

RECOMMENDATION IS THAT COUNCIL:

- 1) Resolve to no longer include business units as part of Council's annual financial statements.

**ORDINARY COUNCIL MEETING – 8 APRIL 2014
COMMITTEE OF THE WHOLE RECOMMENDATION**

	Councillor John Nell Councillor John Morello
	That the recommendation be adopted.

MOTION

085	Councillor Bruce MacKenzie Councillor John Morello
	It was resolved that Council no longer include business units as part of Council's annual financial statements.

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BACKGROUND

As part of the preparation of Council's annual financial statements, a series of special purpose reports are prepared each year detailing the financial results of a number of internal activities. These activities are known as business units.

The purpose of this report is to propose that Port Stephens Council no longer reports any business unit as part of the annual financial statements.

One of the main reasons for preparing the Special Purpose Financial Reports is to satisfy the disclosure requirements under competitive neutrality. The origins of Competitive Neutrality go back to 1993 when the report by the Independent Committee of Inquiry, National Competition Policy (the Hilmer Report), proposed principles for a National Competition Policy framework. In April 1995, the Council of Australian Governments considered the report's recommendations.

A key outcome of that meeting was the Competition Principles Agreement signed by all Australian governments and committing them to applying competition principles to government activities. The Competition Principles Agreement provided the background for the development of the Government's Commonwealth Competitive Neutrality Policy Statement, released in June 1996.

In July 1997 the Department of Local Government released a publication called "Pricing and Costing for Council Businesses – A Guide to Competitive Neutrality". The aim of this document was to assist councils on applying the principle of competitive neutrality as part of the Competition Principles Agreement.

These policy statements set out a small number of activities which are classified by the Australian Bureau of Statistics as business activities. Council was required therefore to regard these activities as businesses. These activities are:

- Water Supply;
- Sewerage Services;
- Abattoirs;
- Gas Production and Reticulation.

Council was also required to proactively look at all other functions to determine whether or not it had any other activity that should be classified as a 'business'.

There are a number of issues that Council has to consider in determining whether an activity should be classified as a business.

These include, but are not limited to:

- Is the activity intended to make a profit?
Clearly, if the intention is to run the activity at a profit, this suggests a clear business activity link;
- Does the Council bid for external contracts?
An activity that bids for external contracts again, is more likely to be considered a business activity than one which is entirely internally focused;
- What economic impact does the activity have?
For example, a small scale activity included as part of a larger scale function may not have a significant impact on the local or regional economy. It may also be inefficient to separate it from the larger function;
- What is the nature of the activity and how important is it to the local community?
Some activities that have a clear community service focus may be extremely difficult to consider as a business activity no matter how large the turnover.

The fact that a function satisfies one or more of the criterion above does not necessarily in and of itself mean that Council is carrying on a business. Council was also required to examine a cost benefit analysis in determining whether or not it discloses and reports on business units.

Once council had determined what activities it would treat as businesses, Council then needed to look at what category of business the activity will fall into for the purposes of competitive neutrality. The categories are based upon the annual sales turnover (annual gross operating income) of the activity:

- Business activities grossing over \$2M per year had to be treated as Category 1 businesses;
- Businesses under this threshold were Category 2 businesses.

The \$2M threshold has been set as a rule of thumb measure of the significance of those activities for the purpose of applying a corporatisation model and pricing requirements.

In determination of the above criterion, Council determined to classify the following activities as a "Category 2 business":

- Property Development;
- Holiday Parks;
- Civil Works;
- Newcastle Airport.

FINANCIAL/RESOURCE IMPLICATIONS

The current process of reporting on the existing four (4) business units being Property Development, Holiday Parks, Civil Works and the Newcastle Airport is manual by nature, time consuming to prepare, confusing to the users of the financial statements, and when assessed on the whole adds no benefit to the users of Council's financial statements.

Whilst Council is not liable to pay taxes such as land tax and payroll tax, for the purpose of these "business unit" reports, Council must "self-assess" the impact of these taxes and deduct the amount in the financial statements. Council must also calculate a notional subsidy received by the "business" based on a notional return on Property Plant and Equipment, including any taxes but excluding any interest payments. Such calculations are contrived, and lead members of the public to think that Council is "propping up" a business, which may in effect, be making a profit.

For example, the business unit known as Holiday Parks contains a mixture of both the Crown Land Holiday Parks, and Council's Holiday Parks operated on land that is either owned or held as trustee. This means that the accumulated surpluses or losses reported against this business activity does not correlate to the externally restricted reserve held on behalf of the Crown holiday parks within the main body of the financial statements.

Secondly, the information contained in the special purpose financial statements for the Newcastle Airport is a direct duplication of the information held within the General Purpose Financial Statements for the Joint Venture.

By eliminating the Special Purpose Financial Statements for business units this will have a reduction in the time taken to complete the financial statements, a reduction in the time taken to audit the financial statements, and remove an area of great complexity from the interpretation of the result of the business units.

Source of Funds	Yes/No	Funding (\$)	Comment
Existing budget	Yes		Cost savings would need to be analysed over a cycle of preparing and auditing statements.
Reserve Funds	No		
Section 94	No		
External Grants	No		
Other	No		

LEGAL, POLICY AND RISK IMPLICATIONS

The principles of the competitive neutrality guidelines are two fold. Firstly, Council needs to assess and determine which functions meet the criterion of a business, once

this decision is made Council then needs to categorise the activity as either a level 1 or level 2 business.

Secondly, Council must have in place a mechanism for answering queries and complaints about potential breaches of competitive neutrality. The decision to remove business units from the annual financial statements does not remove this obligation to have a complaints handling mechanism.

Risk	Risk Ranking	Proposed Treatments	Within Existing Resources?
There is a risk that Council's new auditors may disagree with the proposed treatment.	Medium	Liaise with new external auditors as to the rationale behind the proposal.	Yes
There is a risk that members of the public may comment unfavourably regarding the removal of business units.	Medium	Prepare a communication plan detailing the key points. Highlight that nearly all information contained in the Special Purpose statements is contained in other areas of the financial statements.	Yes

SUSTAINABILITY IMPLICATIONS

Includes Social, Economic and Environmental Implications

Nil.

CONSULTATION

- 1) The Division of Local Government;
- 2) The Productivity Commission of Australia.

OPTIONS

- 1) Accept the recommendation;
- 2) Amend the recommendation;
- 3) Reject the recommendation.

ATTACHMENTS

Nil.

COUNCILLORS ROOM

Nil.

TABLED DOCUMENTS

Nil..