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Internal financial reporting in local government

GOOD
PRACTICE

GOOD PRACTICE GUIDE

Auditing in the Public Interest

AUDITOR GENERAL
VICTORIA

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Foreword

Local governments are faced with an ever-increasing amount of information in their everyday work. Much of this is financial information, derived from transactions and other economic events. Councillors, chief executives and managers need to be adept at collecting, analysing, interpreting and applying this information.

It is an increasingly complex challenge. Accrual accounting and reporting has brought with it sophisticated accounting and management reporting systems. Local governments have become bigger, more complex and subject to more demands for a broader range of higher-quality services.

The challenge for those who govern and those who manage local government is to cut through the available information to find the nuggets that will give them meaningful insights into the financial management of their organisation.

This guide has been developed for both the preparers and the users of financial information. It is based on our recent work examining internal financial reporting of local governments and on a review of relevant literature. We have drawn on the good reporting practices we identified in a number of local governments to present proven and practical solutions that have been implemented and that work.

This guide sets out 4 steps that a local government should take to establish, or to review, its internal financial reporting practices. It includes a check list to support each step, as well as model internal financial reports that are based on good practices. These can be adapted to meet the particular needs of each local government.

This guide deals only with financial information and we acknowledge that this is only part of the story. Local governments will also need non-financial information to manage their organisation. Many of the principles espoused in this guide can be readily adapted to such information. While such reporting is outside the scope of this guide, we strongly encourage it.

JW CAMERON

Auditor-General

About internal financial reports

Importance of good internal financial reports

Good financial information is essential. It is usually provided in 2 types of reports:

- **internal financial reports** to managers and to councillors (the council)
- **external financial reports** to ratepayers, residents and government.

To properly discharge their financial management responsibilities, councillors and managers need internal financial reports to:

- support decisions about resource allocation
- monitor the performance and financial health of their operations
- demonstrate their stewardship of the financial resources for which they are responsible.

Principles of good internal financial reports

The usefulness of internal financial reports for the above purposes depends on their quality. To be useful, internal financial reports (and the information in them) must be:

- relevant
- comparable
- reliable
- understandable.

Relevant

Relevant information meets the needs of users. It is relevant if it is:

- provided in time to influence decisions
- material to decisions the user must make (that is, the user would make a different decision if the information was not available).

People who prepare relevant reports understand and anticipate their readers' information needs. They provide just the right information, and the right amount of information, to meet those needs.

In our special review of local councils' internal financial reports[1], we identified some financial reports that had too much detail, and contained irrelevant information. Other reports left out important information that readers would need to discharge their financial management responsibilities.

Comparable

Financial information should be comparable:

- across reporting periods
- between different organisational units.

To be comparable, information must be collected and reported consistently over time, and in all areas of activity.

It is efficient, and leads to comparable reports, if internal reports are based on the same data as are external reports. This is not to say that internal and external reports should have identical formats or content. Internal reports are just that - for internal use. They should select, interpret and format just the data that managers need. External reports are unlikely to meet all the needs of managers and councillors: although the data in them might be drawn from the same pool of data, it has been selected and formatted differently, to serve different needs.

Reliable

Reliable information is accurate: complete, unbiased and free from errors or mistakes. It shows the reality and substance of transactions and events. Most organisations report on an accrual, rather than cash, basis, because it is generally accepted that this provides more reliable financial information.

[1] Victorian Auditor-General's Office 2004, *Report on Public Sector Agencies,* Government Printer, Melbourne, pp. 133-51.

Understandable

Even if the financial information in internal reports is relevant, comparable and reliable, it is not much use if it is not understandable. Users need to readily comprehend the meaning and significance of the information.

People who prepare internal financial reports must keep in mind the capabilities of their readers. On the one hand, it is fair to presume that readers have a reasonable knowledge of their local government, and of financial matters. If they do not have that knowledge it is, in part, their responsibility to obtain it. On the other hand, even seasoned campaigners and financially literate readers can be misled if information is presented in a distorted or confusing way.

Applying the principles

To apply the above principles, local governments should take the following steps:

- **Step 1:** Define, articulate and gain acceptance of financial management responsibilities
- **Step 2:** Define the financial information relevant to these responsibilities
- **Step 3:** Establish systems and processes to produce financial information that meets the principles
- **Step 4:** Establish report formats and communication methods that maximise understanding.

The following sections of this guide provide practical advice on each of these steps.

Step 1: Define financial management responsibilities

Three levels of responsibility

People need financial information suited to their level of financial management responsibility and authority. The 3 broad levels of financial management responsibility and authority in local governments are:

- the governing body (councillors)
- the chief executive (chief executive officer)
- executive and line managers (senior officers).

The governing body

The *Local Government Act 1989* requires councillors to implement principles of sound financial management. These principles cover financial risk management, revenue and expenditure stability, and intergenerational equity.

The principles require councillors to actively oversee and monitor their local government's operations and balance sheets (their assets, debts and other liabilities) to achieve long-term sustainability. The Act also requires councillors to "establish and maintain a budgeting and reporting framework that is consistent with the principles of sound financial management".

The chief executive

The chief executive's financial management responsibilities also derive from the Act. The Act makes the chief executive officer directly responsible for the design and structure of the local government's administration, and for the day-to-day management of operations. The chief executive officer is also responsible for financial management, by delegation from the council.

Executive and line managers

Executive and line managers derive their financial management responsibilities explicitly by the chief executive officer's delegation of authority to them, and implicitly by virtue of their job role and the resources they manage.

Who is responsible for what?

One of local government's more contentious topics is the lack of clarity between, or lack of acceptance of, the respective roles and responsibilities of councillors and the chief executive officer. Failure to clearly define responsibilities leads to confusion that can weaken accountability and adversely affect the organisation's performance.

The *Local Government Act 1989* mirrors, to an extent, private sector governance principles that clearly separate the roles and responsibilities of the board of directors and management[2]. Under such arrangements:

- the governing body (the board) is responsible for setting strategic direction, for monitoring management performance, and for monitoring control and accountability systems
- the chief executive and senior officers are responsible for implementing the strategic direction, for establishing and operating control and accountability systems, for obtaining resources, and for providing information to the board about the organisation's operations and effectiveness.

Of all levels of government, local government is arguably the best placed to apply private sector governance principles. Councillors are the public sector equivalent of a private sector board that is made up entirely of non-executive directors.

The Municipal Association of Victoria's *Good Governance Guide* has adopted governance principles that mirror private sector practices. The guide states that while a council is ultimately accountable for financial management "… [it] should not have a hands-on role … it needs to ensure that it has information to be satisfied that finances are in order and that budgetary and financial goals are being met"[3].

Good practices – defining financial management responsibilities

Clarify financial management roles and responsibilities of councillors and chief executive and senior officers through formal codification and training

Clear statements of the financial management responsibilities of the mayor, other councillors, the chief executive officer and senior officers underpin the accountability of staff to the local government, and of the local government to ratepayers.

Such statements also help people affected by decisions understand who is responsible for those decisions.

It is incumbent on councillors and managers to ensure that they have sufficient knowledge and understanding to interpret and analyse financial information.

Delegate formal authority to the chief executive and senior officers

Council should make clear and formal statements of its authority that has been delegated to the chief executive and to senior officers.

Responsibilities - and delegated authority - will depend on the requirements of the Act, on the size and complexity of the local government, on the local government's tradition and corporate culture, and on the skills and experience of councillors and managers.

Regularly review responsibilities and delegated authority

Responsibilities and delegated authority should be regularly reviewed, to ensure that they remain appropriate to the local government's needs. Reviews might also be needed after (or in anticipation of) rapid organisational growth, the provision of significant new services, changes in the composition of the council after elections, and changes in chief executive or senior officers.

Table 1 is a generic statement of financial management responsibilities in a local government, and how they might be allocated.

[2] One statement of roles and responsibilities is in the *ASX principles of good corporate governance & best practice recommendations*, April 2003.
[3] *Good Governance Guide*, Municipal Association of Victoria, 2003, p. 32.

Table 1: Example statement of financial management responsibilities

	Council	Chief executive officer	Senior officers
Planning			
Strategic resource plan (s.126 LG Act 1989)	Set key financial and operational parameters for the plan Approve the plan	Prepare the plan within the parameters set by council and submit for approval	Collate and analyse historic and forecast financial and operational data to support plan
Annual plan (s.127 LG Act 1989)	Determine key budget strategies and global resource allocations Review draft budget to ensure consistency with strategies and allocations Approve annual budget and revised budget as required	Establish the annual planning process Set key financial and operational parameters and targets for the plan Review and approve divisional/branch annual operating plans and resource budgets	Develop annual income and expenditure budgets and operational plans for divisional/branch responsibilities
Risk management[4]	Establish a risk management framework Identify and assess strategic risks Oversee and review implementation of the risk management framework	Establish risk management systems and processes Identify and assess organisation-wide risks Design and implement treatments for organisation-wide risks Continuously monitor and report on organisation-wide risks and treatments	Identify and assess operating and financial risks in areas of responsibility Design and implement treatments for operational and financial risks Continuously monitor and report on financial and operational risks and treatments
Operations			
Service delivery	Determine the major functions to be performed and services to be provided by the local government	Design and establish operational, financial and information systems, processes and controls for performing functions and providing services	Implement operational, financial and information systems, processes and controls
Delegated authority	Establish financial and operational delegations of authority to the chief executive officer and senior officers Monitor exercise of delegated authority	Exercise delegated authority Establish financial and operational delegations of authority to senior officers	Exercise delegated authority
Monitoring and review			
Service delivery	Monitor delivery of services at the whole organisation level Monitor exercise of delegated authority	Monitor delivery of services at the divisional level Review and report on the delivery of services at the whole organisation level Report on exercise of delegated authority	Review and report on operating activities and delivery of functions and services against operational plan Report on exercise of delegated authority
Financial	Monitor financial results and position at whole organisation level Monitor efficiency and effectiveness of operating and financial systems, processes and controls	Monitor financial results at divisional level Review and report on financial results and position at the whole organisation level Review and report on the efficiency and effectiveness of operating and financial systems, processes and controls at the whole organisation level	Review and report on financial activities and delivery of functions and services against financial plan Review and report on effectiveness of systems, processes and internal controls at divisional level

[4] For further information about risk management, see Victorian Auditor-General's Office 2004, *Managing risk across the public sector good practice guide*. Available from <www.audit.vic.gov.au>, reports and publications, guides to good practice.

Step 2: Define financial information needs

What drives financial information needs?

A person's need for financial information depends on their financial management responsibilities. These responsibilities derive at the highest level from the legislation governing local government operations, then from delegated authority, and then from the operational responsibilities of particular positions.

Information needs derived from legislation

The *Local Government Act 1989* requires local governments to use their resources efficiently and effectively. It also states that the role of a local government includes (among other things) maintaining its viability by ensuring that it manages its resources in a responsible and accountable manner. The Act explicitly requires councillors to manage financial risks associated with the council's assets and liabilities.

These requirements call for financial information about:

- revenue and expenses, to show the net rate of resource consumption
- assets and liabilities, to assess the impact of current decisions on future resources
- costs of inputs and business processes, to determine whether resources are used efficiently
- unit costs of outputs, to determine the level of cross-subsidisation of services and to set appropriate user fees and charges.

Information needs derived from organisational roles

A council's role, as a governing body, is primarily strategic. Councillors need high level, summarised, whole-organisation information to assess its current and future viability, and to determine the effectiveness of a council's financial management strategies. This includes information about significant departures from the approved strategic resource and annual plans.

The chief executive officer and senior officers also need whole-organisation information but in greater detail, and more frequently, than councillors. They also need the most important operational information.

Line managers need financial information about their area of organisational responsibility and authority. Typically internal budget allocations, operating targets and performance agreements are aligned to organisational structure. However, this does not necessarily mean that the financial information provided is insightful, or is what the line managers really need.

For example, organisational structure may not be closely aligned either with the local government's functions or with the services it provides. Dissecting and reporting financial information in a way that mirrors organisational structure, therefore, may not show the net consumption of resources by each function or service.

As another example, our audit identified a tendency to report only costs that can be easily attributed to organisational units. Some direct costs (such as depreciation) and indirect costs (such as interest expenses) are not always able to be included in line manager's reports, partly because there is no meaningful way to allocate these costs to organisational units. If so, managers in these units will not know the full cost of delivering services, and the extent to which some activities are subsidising others. Managers are, therefore, less likely to take account of these unallocated costs when making financial management decisions.

Information needs derived from a delegated authority

Good governance requires that any person who delegates their authority to another person must require that person to report back to them about the discharge of the delegated authority. Equally, every delegated officer needs information about the resources under their direct authority (and the consumption of those resources), in order to do their job properly.

These requirements call for detailed financial information about budgets and operations that the delegated officer can summarise and report on to the officer who delegated the authority.

Good practices – defining financial information needs

To properly reflect the consumption of resources and the impact of current decisions on future resources, internal financial reports must be presented on an accrual basis.

Internal financial reports must be presented so that users at all 3 levels can see if the local government is operating within the key financial and operational parameters in the strategic resource plan and the annual plan.

Internal financial reports must show the full cost (including all direct and indirect costs) of undertaking each function and providing each service, and any subsidy attributable to the delivery of each service.

Table 2 shows in detail the financial information required by the 3 levels.

Table 2: Sample financial information required by level

	Council	**Chief executive officer**	**Senior officers**
	Organisation level	**Divisional level**	**Branch level**
All financial information	Full accrual	Full accrual	Full accrual
Income and expenditure	Summary: actual and budget, with explanations of major variances from annual plan	Summary: actual and budget, with explanations of major variances from annual plan	Summary: actual and budget, with explanations of major variances from annual plan
	Summary by program: actual and budget, with explanations of major variances from annual plan	Summary by sub-program: actual and budget, with explanations of major variances from annual plan	Summary by project: actual and budget, with explanations of major variances from annual plan
	Significant/material expenditure transactions, including any in excess of delegated authority	Significant/material expenditure transactions, including any in excess of delegated authority	Significant/material expenditure transactions, including any in excess of delegated authority
Cash flows	Summary by activity: actual and budget with explanations of major variances from annual plan	Summary by line item within activity: actual and budget with explanations of major variances from annual plan	Summary by project: actual and budget, with explanations of major variances from annual plan
Assets and liabilities	Summary by class	Summary by class	Summary by class
Costs	Summary unit cost, by service line/output	Summary unit cost, by service line/sub-output	Summary unit cost by activity

Step 3:
Establish controls, systems and processes

Step 2 outlines the information that internal financial reports should provide. However, local government administrations may not be able to provide this information because of the limitations of their information systems and financial reporting processes.

To achieve good practice, local governments need to:

- maintain adequate internal controls over the reliability of their financial information
- invest in information systems that can meet their internal and external reporting needs
- examine their monthly, quarterly and annual "close-the-books" procedures, to produce the required financial information quickly and at minimum cost.

Internal controls

The only way to satisfy users that internal financial reports are reliable and free from material error is to have adequate internal controls over the financial reporting process. Controls can be grouped as management controls, system controls and accounting controls.

Management controls

Management controls are arrangements to monitor and review financial information, and include:

- accurate phasing of income and expenditure budgets by month to facilitate more rigorous analysis of actual results against plan
- reviewing account balances and transactions by line managers to identify errors and to highlight unusual or noteworthy transactions before the books are closed each month
- formal sign-off of reported results by an authorised officer, and written explanations of variances by line managers as part of "close-the-books" procedures.

System controls

Systems controls maintain the integrity of data stored in information systems and include:

- password controls (such as requiring complex passwords and enforcing regular password changes)
- granting levels of system access and power of authorisation to users according to their needs
- physical security arrangements (such as swipe card access to computer rooms and areas that store financial information)
- back-up and recovery arrangements (such as business continuity management plans) that are tested periodically.

Accounting controls

Accounting controls ensure that the transactions on which financial reports are based are complete, accurate and valid, and include procedures to ensure that:

- transactions are initiated by someone with the authority to do so
- financial and physical assets are safeguarded from loss, theft and misuse
- goods and services are paid for only after they have been provided and accepted (unless there is a contractual requirement to prepay)
- entries in the subsidiary and general ledgers are checked for accuracy before and/or after being recorded
- subsidiary systems are regularly reconciled to the general ledger and reviewed by someone not involved in the reconciliation.

Information systems

A local government's financial management information system (FMIS) should be integrated, flexible and accessible.

Integrated

All the systems that record the data used in internal financial reports should be integrated. The ideal, integrated system is one that handles online, real-time processing of transactions, and updates financial data for reporting purposes when transactions are recorded in subsidiary systems. This gives decision-makers access to completely up-to-date financial information and eliminates batch processing that creates bottlenecks and delays the production of financial reports.

However, given the way systems develop over time, and the diversity of local government information requirements, this level of integration might not be totally achievable.

At the least, the general ledger and subsidiary systems covering common accounting processes (such as purchasing and accounts payable, payroll and employee entitlements, fixed asset accounting, and revenue and receivables) should be integrated.

The FMIS should also be able to interface directly with a range of third-party software (such as asset management software). Where this is not possible, local governments should automate processes to exchange data between systems.

Flexible

The reporting function of the FMIS (whether built-in or added-on) should be able to produce reports, from the same data, for the whole organisation, or by function, program or service.

As the local government's organisational structure changes, the FMIS should allow for easy restructuring of the general ledger chart of accounts.

Accessible

The FMIS should be accessible to all authorised users at the 3 levels of responsibility, so that everyone uses the same data when making decisions.

The FMIS should be robust enough, and have enough capacity, to handle multiple queries at the same time. It should also provide quick responses.

Users should be able to drill down to the level of detail they need to make decisions. Line managers need real-time access to transaction-level data, and this data should ideally be available to all users.

It should not be necessary to export and manually manipulate data to meet information requirements.

"Close-the-books" procedures

Procedures to "close-the-books" at the end of a period can be a major impediment to timely production of periodic financial information.

Materiality

The amounts contained in financial reports are not always 100 per cent accurate, although it is a common misconception that they are, and need to be so. Rather, there must be no "material" errors. Material errors are omissions or misstatements of a magnitude that would make a reader change a judgement based on the information in the financial reports.

Accordingly, amounts need be sufficiently accurate so that decisions based on the reports would have been the same had the precise, correct amounts been provided.

Some reported information (such as accruals or provisions) will seldom be 100 per cent accurate, given the inherent uncertainty in some calculations because of the long time frames involved, and the reality that some are based on judgements.

Many organisations apply these concepts by adopting a "soft close" approach when preparing financial information that is only for internal use (and particularly for monthly reports). Taking this approach, only key reconciliations are performed. Also, some accruals and provisions are either not computed or are estimated; and they are then adjusted only quarterly or annually as part of the "hard close".

Timing

Many local governments start to close their books after the last day of the reporting period. However, to smooth the workload and reduce bottlenecks, some steps can be taken before the end of the period. These include:

- closing off the ledger one or 2 days before the end of the period
- running accounting routines (such as depreciation and employee provisions) just before the end of the month
- performing key reconciliations during the month
- running a first cut of the trial balance at the end of the period and asking line managers to identify and correct any errors and unexpected results
- requiring line managers to explain variances before the "final" trial balance is run.

Good practices – establishing controls, systems and processes

The internal controls established to ensure reliable financial reporting should be reviewed regularly to ensure that they remain effective. Management "control self-assessment" and internal audits are the principal means by which this can be achieved.

An analysis should be undertaken between the financial information needs required by each of the 3 levels, as determined in Step 2, and the information provided by the current FMIS. The analysis should clarify whether any information gaps arise because of lack of data, lack of system functionality or lack of user knowledge. Each cause requires a different treatment.

A formal process of "accountability" sign-offs of financial reports should be established at each management level. This provides assurance to the chief executive officer and council that the information in financial reports is complete, accurate and reliable.

Step 4: Making information understandable

The energy, time and resources invested in making financial information relevant and reliable is largely wasted if readers of financial reports do not understand what is in them.

Making information understandable includes consideration of both presentation and content.

Good report presentation practices

Report format

Perhaps the least user-friendly report format is pages and pages of tables, with columns and columns of financial information. This format demands that readers have a good understanding of accounting and financial reporting concepts, can read and interpret financial information, and can spot the significance of changes in balances and "bottom lines".

Such formats should be consigned to report appendices to provide the detail (if readers want it) to support financial information that is presented in simpler and clearer formats and layouts in the main body of the report.

Appendix A of this guide provides examples of internal financial report formats.

Report order

Good reports have a logical flow to the information. Usually, this starts at the highest level (the organisational level) and cascades down to divisional and branch level.

Summary information should be provided at the start of each section of a report - a "report on a page" - to highlight key results. This will allow the reader to determine whether they need to drill down to the next level of detail in that section.

Report layout

Good reports have clear, simple layouts. They are not cluttered, and there is not too much detail on each page.

The report layout should draw the users' attention to the key areas for consideration and decision.

Where possible, use graphs and charts instead of tables of figures. They are especially powerful tools for highlighting trends and making comparisons (such as between different periods, or between organisational units).

If using charts:

- select the appropriate type of chart: lines to illustrate trends over time for one or more series, and bars (or a mixture of bars and lines) for comparisons (such as actual to budget, or prior year and current year, comparisons)
- do not make charts 3-dimensional
- select scales appropriate to the quantities displayed
- use common absolute scales (or preferably percentages) and similar size charts throughout the report
- do not use double axis charts with different scales
- use little or no shading
- remove unnecessary lines.

Good practices – making information understandable

Our audit of local government internal financial reporting shows that what was contained in financial reports varied widely. Most reports included information about resource consumption and financial position (and less often about cost). However, the extent to which financial information was aggregated and summarised in reports varied significantly among local governments. For example, some councillors received reports (one of over 50 pages) that detailed every transaction for a month. Many councillors received detailed reports down to cost centre or branch level. Some councillors only received summary financial information at the whole organisation level. Better practice suggests this latter approach of "less is more" is the most appropriate.

When developing report content:

- use ratios to highlight and explain key relationships that are not evident from raw data: Appendix B of this guide provides examples of financial ratios
- report by exception: draw attention to areas where action is most required, and establish tolerances and desired or expected results and highlight only the data that falls outside these parameters
- do not rely on the figures alone to tell the story: analyse the data and add commentary to ensure that readers focus on the points being made.

Appendix A: Model financial report

This appendix contains examples of the type of information that could be provided in monthly and quarterly financial reports.

Councillors would be provided with the financial health indicators and the summary financial statements. They may also wish to track the progress of major capital projects.

The ratios used in this example are discussed in Appendix B of this guide.

A model council

Financial report for month ended

dd mm yyyy

Contents

Financial health indicators

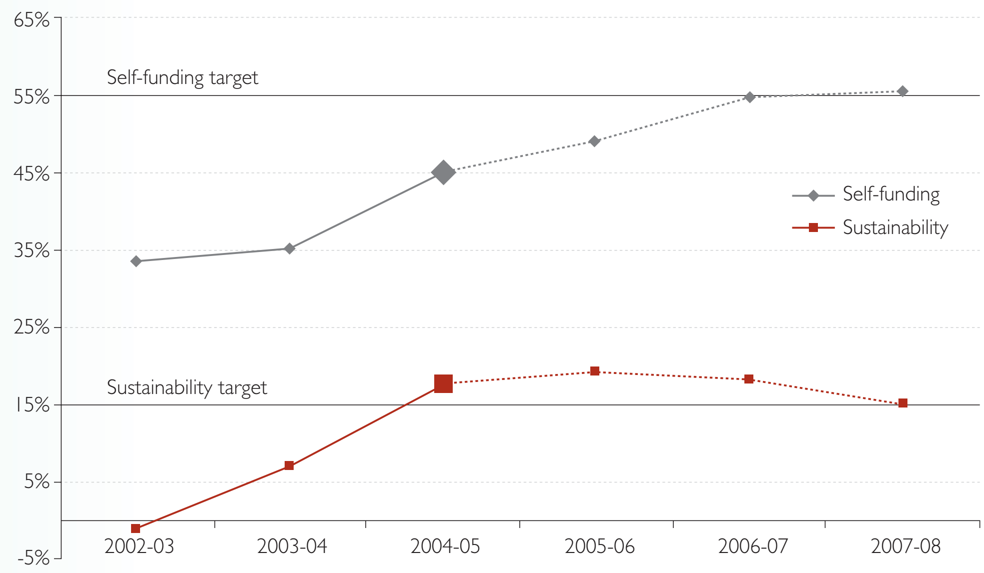
- Key strategic financial indicators
- Key operational financial indicators
- Summary financial statements

Attachments: Detailed financial statements

Financial health indicators

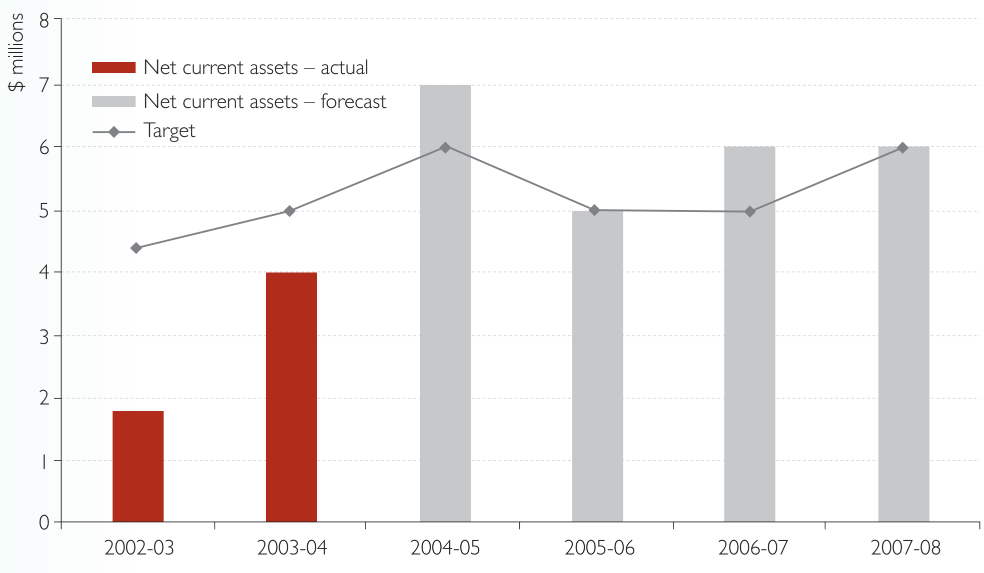
Key strategic financial indicators: trend analysis (sample charts)

CHART 1: Self-funding capacity and operating result



Note: Discuss any factors influencing trends.

CHART 2: Net current asset position



Note: Discuss any factors influencing trends.

Key strategic financial indicators at dd mm yyyy

Operating ratios

	Target	*Actual*	*Variance*	*F/U*[i]	*Trend*
Revenue flexibility					
Own source/operating revenue	55%	45%	(10%)	U	↗
Sustainability					
Operating surplus/operating revenue	15%	17.5%	2.5%	F	↗

Leverage ratios

	Target	*Actual*	*Variance*	*F/U*	*Trend*
Working capital					
Current assets/current liabilities	2.0	1.6	(0.4)	U	↗
Debt burden					
Total debt/own source revenue	25%	20%	5%	F	↔

Cash ratios

	Target	*Actual*	*Variance*	*F/U*	*Trend*
Self-funding capacity					
OCF/operating revenue	20%	15%	(5%)	U	↘
Liquidity					
Unrestricted cash/current liabilities	1.1	1.2	0.1	F	↔

Asset investment ratios

	Target	*Actual*	*Variance*	*F/U*	*Trend*
Renewal gap					
Renewal/depreciation	130%	85%	(45%)	U	↗
Capital self-financing					
OCF/capital spend	100%	110%	10%	F	↔

(i) Establish acceptable tolerances for variances (say +/- 10 per cent) and provide commentary where actual result is outside the range of tolerance.

Commentary

Provide brief notes here on any current year factors impacting on achievement of long-term strategic targets.

Key operational financial indicators at dd mm yyyy

Efficiency ratios

	Target	*Actual*	*Variance*	*F/U*[(i)]	*Trend*
Labour					
Employee benefits/revenue	45%	47%	(2)	U	↗
Return on investment					
Interest revenue/average investments	6.5%	4.9%	(1.6)	U	↔
Debt recovery					
Trade debtors/revenue	3%	2%	1	F	↗
Infringements debtors/revenue	15%	20%	(5)	U	↔
Unit costs of services					
$ total cost/units of service/outputs					
Garbage collection (per bin)	$1.50	$1.49	0.01	F	↔
Home care (per hour)	$25.50	$33.33	($7.83)	U	↘
Leisure centre (per patron)	$4.50	$8.90	($4.40)	U	↗

(i) Establish acceptable tolerances for variances (say +/- 10 per cent) and provide commentary where actual result is outside the range of tolerance.

Commentary

Provide brief notes here on any current period factors impacting on achievement of operational efficiency targets.

Summary financial statements

A. Summary financial results for the year to date dd mm yyyy

A. Income statement

	Year-to-date Budget	Actual	Variance			Comments
	($m)	($m)	($)	(%)	(F/U)	
Own-source revenues	35.0	34.3	(0.7)	2.0	U	
Total revenues	51.5	48.7	(1.8)	3.5	U	*Capital grant $1.5 million delayed
Employee expenses	(31.1)	(29.8)	0.3	1.0	F	
Total expenses	(48.3)	(46.4)	1.8	3.7	F	
Operating result	**3.2**	**2.3**	**(0.9)**	**28.1**	**U**	**Unlikely to meet target

B. Balance sheet

	Year-to-date Op.bal.	Actual	Movement			Comments
	($m)	($m)	($)	(%)	(F/U)	
Cash and equivalents	17.6	17.3	(0.3)	1.7	U	
Current assets	22.5	20.5	(2.0)	8.9	U	
Current liabilities	(10.8)	(8.7)	2.1	19.4	F	
Non-current assets	372.2	369.3	(2.9)	0.8	U	
Borrowings	(2.1)	(1.6)	0.5	23.8	F	*Retirement of debt as planned
Non-current liabilities	(3.5)	(3.9)	(0.4)	11.4	U	
Net assets	**380.4**	**377.2**	**(3.2)**	**0.8**	**U**	

C. Cash flows

	Year-to-date Budget	Actual	Variance			Comments
	($m)	($m)	($)	(%)	(F/U)	
Net operating	12.1	13.2	1.1	9.1	F	
Net investing	(11.2)	(8.9)	2.3	20.5	F	
Net financing	(0.6)	(0.5)	0.1	16.7	F	
Restricted cash	2.2	3.3	1.1	50.0	F	
Unrestricted cash	**15.4**	**20.0**	**4.6**	**29.9**	**F**	

D. Capital program

	Year-to-date Budget	Actual	Variance			Comments
	($m)	($m)	($)	(%)	(F/U)	
Renewal	5.5	5.6	0.1	1.8		
Upgrade	2.2	1.5	(0.7)	31.8	U	**Need to accelerate program
Expansion	0.5	0.0	(0.5)	100	U	**Delay in start – should complete
New assets	4.5	2.5	(2.0)	44.4	U	**Will not complete program
Total	**12.7**	**9.6**	**(3.1)**	**24.2**	**U**	

Key to symbols: * for information only; ** - action required

Attachments

- A.1 Statement of financial performance by line item
- A.2 Statement of financial performance by program
- B Statement of financial position
- C Statement of cash flows
- D.1 Statement of capital expenditure by type
- D.2 Statement of capital expenditure by asset class
- D.3 Statement of capital expenditure by major project

A.1: Monthly summary revenue and expenditure report (by line item)

Last Yr		Notes	This period			Year-to-date			Full year		
			Budget	Actual	Variance	Budget	Actual	Variance	Budget	Forecast	Variance
($'000)			($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)
	Revenues										
	Rates (pro-rata "earned")										
	User fees and charges										
	Operating grants										
	Capital grants										
	Interest										
	Other										
	Total operating revenues										
	Expenses										
	Employee entitlements										
	Payments to suppliers										
	Depreciation										
	Interest										
	Other										
	Less: Total operating expenses										
	Net revenues and expenses										
	Add: Net contributed assets										
	Net operating surplus										

Notes (for variances >10 per cent or $50 000):

	Reason for year-to-date variance	Action required/taken to correct variance
1.		
2.		

A.2: Monthly summary revenue and expenditure report (by program)

Last Yr		Notes	This period			Year-to-date			Full year		
			Budget	Actual	Variance	Budget	Actual	Variance	Budget	Forecast	Variance
($'000)			($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)
	Program 1 (name)										
	Revenue										
	Expenses										
	Program 2 (name)										
	Revenue										
	Expenses										
	Program 3 (name)										
	Revenue										
	Expenses										

Notes (for variances >10 per cent or $50 000):

	Reason for year-to-date variance	Action required/taken to correct variance
1.		
2.		

B: Monthly summary assets and liabilities report

Last Yr		Notes	Monthly movement			Year-to-date movement			Full year		
			Prior	Current	Change	Last yr	Current	Change	Budget	Forecast	Variance
($'000)			($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)
	Assets										
	Cash and equivalents										
	Investments -										
	Financial										
	Property										
	Receivables -										
	Rates										
	Other										
	Land - for resale										
	Infrastructure -										
	Land and buildings										
	Roads, drains, bridges										
	Other assets										
	Total assets										
	Liabilities										
	Employee benefits										
	Trade creditors and accruals										
	Borrowings -										
	Short-term										
	Long-term										
	Trust moneys and deposits										
	Total liabilities										
	Current assets										
	Current liabilities										
	Non-current assets										
	Non-current liabilities										

Notes (for variances >10 per cent or $50 000):

	Reason for year-to-date change	Action required/taken to correct variance
1.		
2.		

C: Monthly summary cash flow report

Last Yr		Notes	This month Budget	This month Actual	This month Variance	Year-to-date Budget	Year-to-date Actual	Year-to-date Variance	Full year Budget	Full year Forecast	Full year Variance
($'000)			($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)
	Cash inflows from operations –										
	Rates										
	User fees and charges										
	Operating grants										
	Capital grants										
	Interest										
	Other										
	Total operating cash inflows										
	Cash outflows from operations –										
	Employee entitlements										
	Payments to suppliers										
	Interest										
	Other										
	Total operating cash outflows										
	Net cash flows from operations										
	Financing cash flows –										
	New borrowings										
	Repayment of borrowings										
	Net financing cash flows										
	Investing cash flows –										
	Proceeds on disposal of assets										
	Acquisition of assets										
	Net investing cash flows										
	Net combined cash flows										
	Add: Opening cash balance										
	Closing cash balance										

Notes (for variances >10 per cent or $50 000):

	Reason for year-to-date variance	Action required/taken to correct variance
1.		
2.		

D.1: Monthly summary capital revenue and expenditure report by category (all projects)

Last Yr	*Notes*	*This month* Budget	Actual	Variance	*Year-to-date* Budget	Actual	Variance	*Full year* Budget	Forecast	Variance
($'000)		($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)
	Renewal of existing assets –									
	Capital grants and contributions									
	Renewal expenditure									
	Upgrade of existing assets –									
	Capital grants and contributions									
	Upgrade expenditure									
	Acquisition of new assets –									
	Capital grants and contributions									
	Acquisition expenditure									
	Total –									
	Capital grants and contributions									
	Renewal, upgrade and acquisition									

Notes (for variances >10 per cent or $50 000):

	Reason for variance	Action required/taken to correct variance
1.		
2.		

D.2: Monthly summary capital revenue and expenditure report by asset class (all projects)

Last Yr	*Notes*	*This month* Budget	Actual	Variance	*Year-to-date* Budget	Actual	Variance	*Full year* Budget	Forecast	Variance
($'000)		($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)
	Land improvements –									
	Capital grants and contributions									
	Renewal expenditure									
	Buildings –									
	Capital grants and contributions									
	Upgrade expenditure									
	Road network –									
	Capital grants and contributions									
	Acquisition expenditure									
	Open space –									
	Capital grants and contributions									
	Renewal, upgrade and acquisition									
	Plant and equipment –									
	Capital grants and contributions									
	Renewal, upgrade and acquisition									

Notes (for variances >10 per cent or $50 000):

	Reason for variance	Action required/taken to correct variance
1.		
2.		

D.3. Summary capital revenue and expenditure report by project (> $1 million)

Last Yr	Notes	This year-to-date Budget	Actual	Variance	Inception-to-date Budget	Actual	Variance	Full project cost Budget	Forecast	Variance
($'000)		($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)	($'000)
	Major projects (> $1m)									
	Project 1 – name									
	Project 2 – name									
	Project 3 – name									

Notes (for variances >10 per cent or $50 000):

	Reason for variance	Action required/taken to correct variance
1.		
2.		

Appendix B: Example financial ratios

Strategic financial ratios

The following ratios are examples of those that could be tracked by councillors and the chief executive officer to monitor financial health. Targets for each ratio should be set as part of the strategic planning process for the period of the corporate plan. Strategies should then be implemented to achieve those targets.

Measure	*Comments on ratio*
Revenue ratios	
Self-reliance $\frac{\text{Own-source revenue}^{1}}{\text{Total underlying operating revenue}^{2}}$	This ratio indicates the ability of the local government to generate its own revenues, and thus its self-reliance. The higher the proportion of revenue that the local government generates from its own operations, the more control it has over recurrent sources of funding. There is less reliance on grants and cash contributions that are outside their control, and which may be inconveniently timed, or which may simply stop. Also, many outside revenue sources (such as grants) are also tied to specific purposes and cannot be used to meet discretionary expenditures (although untied recurrent grants can be included as independent revenue).
Sustainability $\frac{\text{Underlying operating result}^{3}}{\text{Total underlying operating revenue}}$	This ratio indicates the extent to which local government's operations are sustainable in the longer-term. Ideally, this ratio will always be positive. Local governments with large and/or persistent underlying operating deficits may not be retaining sufficient funds to maintain their infrastructure. This may lead to sudden and large funding requirements that they cannot finance from their operations.
Asset ratios	
Liquidity $\frac{\text{Unrestricted}^{4}\text{ cash and liquid financial assets}}{\text{Current liabilities}}$	This ratio indicates the ability of the local government to meet its short-term obligations. This ratio should exceed 1:1. A ratio of 1:1 indicates the ability to pay all current liabilities, if necessary, from their cash and liquid financial assets. Those councils with ratios less than 1:1 may need to rely on short-term debt and emergency funding sources (such as overdrafts), which can be costly. Local governments recognise revenue from some grants, contributions and transfers without recognising an associated liability. If so, they should adjust the numerator (top line) of the ratio to recognise any restrictions on purpose, or lack of offsetting liabilities.
Working capital $\frac{\text{Current assets}}{\text{Current liabilities}}$	This ratio indicates the amount by which short-term assets exceed short-term obligations. The amount of excess current assets over current liabilities required is dictated by the requirement to fund recurrent operations. Ideally, working capital ratios will be close to or exceed 2:1, for comfort.
Liability ratios	
Debt burden $\frac{\text{Debt}^{5}\text{ servicing and redemption costs}}{\text{Own source revenue}}$	This ratio indicates the ability of a local government to pay interest on its loans, and to repay the loans, from the revenue that it generates from its own operations. Prudential ratios already established by the government for this measure use rates revenue, which is narrower than all own-source revenue.
Asset investment ratios	
Self-funding investment $\frac{\text{NOCF}^{6}\text{ and investing inflows}}{\text{Investing cash outflows}}$	This ratio indicates the utilisation of owned-sourced funds for the acquisition of non-current assets. Over the long-term, this ratio should exceed 1:1. The higher the ratio the more local governments are able to use their own funds to buy assets, and so minimise their reliance on borrowings.
Asset renewal gap $\frac{\text{Investing cash outflows (renewal)}^{7}}{\text{Depreciation expense (existing assets)}}$	This ratio indicates the extent to which the renewal of existing assets is keeping pace with the decline in the service potential of existing assets. Ideally, this ratio should be in excess of 1:1 over the medium- to long-term. Investing cash outflows that relate to new assets are excluded. Local governments with ratios persistently below 1:1 may be under-funding asset renewal, and may need to invest large amounts in future, to maintain their assets in an adequate condition.

Definitions

1. **Own-source revenue:** accrual revenue from activities undertaken and directly controlled by the local government, such as rates and municipal charges, user fees, fines and other service charges. Excludes grants and developer contributions.
2. **Total underlying operating revenue:** total revenue as shown in the operating statement adjusted to remove "non-cash" developer contributions and one-off items (such as "found" assets and asset write-offs).
3. **Underlying operating surplus/deficit:** full accrual operating result adjusted to remove non-cash developer contributions and one-off adjustments to revenue and expenditure that are not likely to recur or are "abnormal".
4. **Unrestricted:** cash or revenue not tied to a specific purpose by legislation, regulation or enforceable agreement with a third party.
5. **Debt:** external borrowings, including finance leases.
6. **NOCF:** net operating cash flows.
7. **Investing cash outflows (renewal):** expenditure to extend the service potential of existing assets, either by replacing or upgrading them.

Operational financial ratios

The following ratios are examples of those that could be tracked by executive and line managers. Targets for each ratio should be set as part of the operational planning process for the period of the corporate plan. Strategies should then be implemented to achieve those targets.

Measure	*Comments on ratio*
Revenue ratios	
Employee benefits $\frac{\text{Employee expenses}}{\text{Own source revenue}}$	Typically, labour costs are the biggest discretionary operating expenditure item for a local government. This ratio (expressed as a percentage) shows what percentage of own-source revenue is spent on expenses and indicates a local government's sensitivity to changes in these expenses.
Return on investments $\frac{\text{Interest earned}}{\text{Average cash/investment balance}}$	This ratio (expressed as a percentage) indicates the average return on unutilised cash and investment balances. To indicate performance, it can be compared with an appropriate, risk-free reference rate applicable to the average term to maturity of the investments.
Overdue debtors $\frac{\text{Outstanding rates debtors}}{\text{Rates revenue}}$ $\frac{\text{Outstanding trade debtors}}{\text{Fees and charges revenue}}$ $\frac{\text{Unpaid fine debtors}}{\text{Fine revenue}}$	These 3 ratios indicate how efficiently a local government's 3 main types of debts are converted into cash. If a significant proportion of debtors is overdue, the local government may either need a higher level of working capital than it would otherwise need, or it may have to defer payments to suppliers or planned capital works because it lacks cash. It is necessary to pro rata rates revenue and debtors for this measure to be meaningful during the year. For intra-period reporting rates revenue is based on quarterly instalment notices. Overdue debtors are those unpaid by quarterly instalment due date. Debtors ageing should be undertaken to establish percentage of outstanding debt that is overdue.
Expense ratios	
Cost per unit $\frac{\text{Cost of service (\$)}}{\text{Total service units (\#)}}$	This ratio indicates how efficiently services are being provided.
Maintenance backlog $\frac{\text{Actual maintenance}}{\text{Planned maintenance}}$	This ratio indicates the level of investment in asset maintenance. A ratio consistently over 1:1 may indicate that assets are deteriorating faster than planned, and will not reach their expected service lives.

Appendix C: Diagnostic tool

The following check list can be used by those with financial management responsibilities to determine whether their financial information needs are being met and to diagnose any problems with internal financial reporting processes. It is recommended that responses are obtained from, and separately collated and analysed for:

- councillors
- the executive management team (the chief executive officer and division heads)
- line managers (branch heads).

There are questions where respondents (particularly councillors) will not have direct knowledge of the answer. These respondents should, nevertheless, provide their perception of the actual situation, to identify where their perception differs from other groups.

It may also be appropriate for external members of the audit committee to participate in the review. Given its role, the audit committee will no doubt be interested in the outcome of the analysis.

Review of internal financial reporting check list

Quality characteristic	***Good practice met***	***Action plan***	***Responsibility/ target date***
Relevance of information			
Financial management responsibilities are clearly defined and have been formally articulated	***Yes*** ☐ ***In part*** ☐ ***No*** ☐		
Financial delegations of authority are appropriate at each level, match organisational needs and are up-to-date	***Yes*** ☐ ***In part*** ☐ ***No*** ☐		
Internal financial reports are prepared on a full accrual basis	***Yes*** ☐ ***In part*** ☐ ***No*** ☐		
Monthly, year-to-date and annual targets (including budgets) are established for key financial ratios and results	***Yes*** ☐ ***In part*** ☐ ***No*** ☐		
Internal financial reports provide timely information on achievement against targets (including budgets)	***Yes*** ☐ ***In part*** ☐ ***No*** ☐		
Internal financial reports are dissected by organisational structure and by program responsibility (where different from organisational structure)	***Yes*** ☐ ***In part*** ☐ ***No*** ☐		
Internal financial reports provide timely information on the net cost of each service provided by council	***Yes*** ☐ ***In part*** ☐ ***No*** ☐		
Internal financial reports provide timely information on the unit cost of each output	***Yes*** ☐ ***In part*** ☐ ***No*** ☐		

Quality characteristic	*Good practice met*	*Action plan*	*Responsibility/ target date*
Reliability of internal financial information			
Information in internal financial reports is reliable	*Yes* ☐ *In part* ☐ *No* ☐		
Internal financial reports are formally signed-off by the managers responsible for the underlying transactions and balances reported therein	*Yes* ☐ *In part* ☐ *No* ☐		
Month, year-to-date and annual forecasted targets and budgets are reviewed regularly and internally revised when required	*Yes* ☐ *In part* ☐ *No* ☐		
Access controls over the financial information systems are adequate and operate effectively	*Yes* ☐ *In part* ☐ *No* ☐		
Power supply arrangements, data back-up routines, off-site storage arrangements and recovery procedures are adequate and tested	*Yes* ☐ *In part* ☐ *No* ☐		
Accounting controls over authorisation, accuracy, classification and disclosure are adequate and operate effectively	*Yes* ☐ *In part* ☐ *No* ☐		
Financial systems are fully integrated. The need for manual intervention and re-keying is minimised	*Yes* ☐ *In part* ☐ *No* ☐		
Data in financial systems is accessible by those who need it	*Yes* ☐ *In part* ☐ *No* ☐		
Reporting tools are user-friendly	*Yes* ☐ *In part* ☐ *No* ☐		

Quality characteristic	Good practice met	Action plan	Responsibility/ target date
Understanding			
Internal financial reports are the right length	**Yes** ☐ **In part** ☐ **No** ☐		
An executive summary or synopsis is provided to highlight key results and issues	**Yes** ☐ **In part** ☐ **No** ☐		
Charts and graphs are used to aid understanding in preference to data tables	**Yes** ☐ **In part** ☐ **No** ☐		
Key financial ratios and trends are included in the report and used to explain key financial relationships	**Yes** ☐ **In part** ☐ **No** ☐		
Significant variances from budget are fully explained and analysed in terms of their impact on forecasted results	**Yes** ☐ **In part** ☐ **No** ☐		
Explanations include corrective action and/or provide sufficient information on which to take decisions about the need for re-allocation of resources	**Yes** ☐ **In part** ☐ **No** ☐		

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