Government of **Western Australia**
Department of **Local Government and Communities**

Local Government Operational Guidelines

Number 08 – June 2013

Net Current Assets (Opening and Closing Funds) Used in the Annual Budget and the Annual Financial Report

1. Introduction

Elected members and senior staff are well aware of the need for sound financial management of their local government's resources. It is essential that local governments have meaningful and accurate financial information on which to base decisions. A key element of sound financial management is the preparation of the annual budget and this guideline addresses an integral element of the budget process – net current assets (opening funds) carried forward from the previous financial year and closing funds.

The calculations of opening funds brought forward at 1 July from the previous financial year, and closing funds carried forward at 30 June into the next financial year in the rate setting statement of the budget, have a direct impact in the determination of the amount of rates to be raised, and whether it is a balanced, surplus or deficit budget. Some local governments have found themselves in difficulties over miscalculation of these funds. Errors have led to situations where the funds available during the year have been less than that required to deliver the services and facilities provided for in the budget. In other cases councils have imposed higher rate increases than were necessary.

This guideline uses a typical rate-setting statement and through a series of examples, demonstrates how the opening and closing funds should be calculated.

Adherence to the methodology contained in this guideline will ensure that the method of calculation will become more consistent and accurate across the local government sector.

In compiling this guideline the Department is aware that it is a technical issue and many elected members will be prepared to leave the calculations to local government staff. The target audience is local government staff who need to know about the calculation and interpretation of such figures and those elected members such as chairs of finance committees who also need to understand the technique and implications of the calculations.

It is intended that the guideline will alert elected members who have little or no training in financial matters of the importance of such calculations. As a consequence of this guideline all elected members should seek assurances from the staff that the methodology outlined and due diligence have been applied in producing a set of opening and closing balances.

If, after studying this guideline, elected members need further explanation of this aspect of financial management, it is recommended that they speak to the relevant officers in their local government.

2. Legislation

Various sections of the *Local Government Act 1995* (the Act), and *Local Government (Financial Management) Regulations 1996* (FMR) relevant to this topic are addressed below.

2.1 Preparation of the Annual Budget

Section 6.2(2) of the Act requires that in preparation of the annual budget local governments are to prepare detailed estimates for the budget year of –

(a) "The expenditure by the local government; and
(b) the revenue and income, independent of general rates, of the local government; and
(c) the amount required to make up the deficiency, if any, shown by comparing the estimated expenditure with the estimated revenue and income".

2.2 Rates and service charges

Section 6.32(1) of the Act provides:

"When adopting the annual budget, a local government –

(a) In order to make up the budget deficiency, is to impose a general rate on rateable land within its district …"

2.3 Limit on the amount to be raised from rates

Section 6.34 of the Act provides that –

"Unless the Minister otherwise approves, the amount shown in the annual budget as being the amount it is estimated will be yielded by the general rate is not to –

(a) be more than 110% of the amount of the budget deficiency; or
(b) be less than 90% of the amount of the budget deficiency".

This is explained in further detail under Part 6 of the guideline.

2.4 Position at the Start of the Financial Year

FMR r. 31 requires the net current assets at the start of the financial year to be shown in the annual budget.
FMR r. 32 prescribes the amounts that may be excluded in calculation of the budget deficiency in accordance with section 6.2(3).

Guidance on the interpretation of these regulations is detailed in the table below:

FMR	Description	Interpretation
r. 31	Net current assets at start of financial year to be shown	
r. 31 (1)	The annual budget is to include the net current assets carried forward from the previous financial year.	The term 'net current assets' is defined in FMR r 3 to mean "the net difference between the total current assets and the total current liabilities at 30 June."
r. 31 (2)	If at the time of preparation of the annual budget the net current assets is not known, an estimate of that figure may, if it is disclosed as an estimate, be included in the annual budget.	If an estimate is used, a reasonable attempt should be made to calculate the estimate as close as possible to the final figure that will be reported in the audited annual financial report. A zero estimate is not considered reasonable. When the audit of the previous financial year is finalised, any variance between the budget estimate and the audited actual calculations must be addressed in the budget review.
r. 31 (3)	The annual budget is to include or be accompanied by notes containing –	
r. 31 (3)(a)	A summary explaining the composition of the net current assets.	It is recommended that this summary be included in a note titled Net Current Assets, be comprehensive and show all current assets and current liabilities prior to making any additions and deductions. This will ensure that the net current assets agree with the statement of financial position.

FMR	Description	Interpretation
r. 31 (3)(b)	If the net current assets differs from the figure used in the rate setting statement, a disclosure of the difference and a brief explanation of the reason for the difference.	It is clear that this regulation requires net current assets to be used in the rate setting statement although this is usually described as the opening funds brought forward from the previous year. If they are different, an explanation must be provided by way of note. Differences could include: Excluding land held for resale under current inventory if there is any doubt that the sale may not occur, so that there is no adverse impact on cash flow during the budget year if the sale does not eventuate. If it is excluded but a sale does eventuate, this can be adjusted through subsequent budget review or be reflected in the net current assets at 30 June. Adding back current portion of long-term borrowings shown as a current liability to avoid double counting, as this is typically provided for in the annual budget. Excluding self-supporting loan repayments from accruals to avoid double counting as this is typically provided for in the annual budget.
r. 32	Amounts which may be excluded in calculation of budget deficiency – section 6.2(3). A local government may exclude from the calculation of the budget deficiency –	
r. 32 (a)	Money borrowed or to be borrowed, to the extent that it is proposed in the annual budget to remain unspent at the end of the financial year;	Any money that will be borrowed that will not be used by 30 June at the end of the budget year is to be excluded.

FMR	Description	Interpretation
r. 32 (b)	Reserves, to the extent that they are proposed in the annual budget to remain unspent at the end of the financial year;	The balance of section 6.11 restricted cash reserves anticipated at 30 June of the budget year is to be excluded. The opening balance of cash reserves is excluded in the opening surplus/deficit at 1 July. The change in this balance by 30 June is achieved by the net difference between transfers to and transfers from cash reserves detailed in the rate setting statement.
r. 32 (c)	In relation to a land transaction or trading undertaking, assets and liabilities, to the extent to which they are proposed in the annual budget to remain restricted to the purposes of the land transaction or trading undertaking at the end of the financial year;	The value of current assets and current liabilities to be restricted at 30 June would be excluded from the rate setting statement and be detailed in a supporting note.
r. 32 (d)	Any proposed amounts of depreciation of non-current assets;	Depreciation expense should be excluded in the rate setting statement as this is a non-cash item and is unnecessary to fund in the budget if proper asset management is practised and renewals/replacement funded as capital expenditure. Note that profit or loss on disposal of assets should be adjusted too, as this, like depreciation is a non-cash item.
r. 32 (e)	Assets from grants or gifts or non-cash revenue or expenditure;	In the rate setting statement the amount of the gifted asset should be shown separately to other asset purchases and a corresponding revenue amount shown to recognise the value of the gift or donation of the asset.

FMR	Description	Interpretation
r. 32 (f)	Current liabilities which, by their nature, are restricted, to the extent that they are proposed in the annual budget to remain uncleared at the end of the financial year;	Note that the regulation refers to current liabilities that are '**restricted**'. Typically this would be the liability associated with bonds, deposits and retentions if these are held in the municipal fund. However, to avoid double-counting, a further adjustment can be made for the portion of leave provisions that is supported by a cash backed restricted reserve or the value of leave to the extent that it is otherwise funded in the annual budget.
r. 32 (g)	Any other current assets which, by their nature, are restricted, to the extent that they are proposed in the annual budget to remain unused at the end of the financial year.	Note that the regulation refers to current assets that are '**restricted**'. Typically this would be the cash bonds, deposits and retentions if these are held in the municipal fund. In addition, tied grants and contributions received that will not be fully utilised by the end of the financial year would also be restricted. In the budget calculations, if restricted cash is deducted that will be utilised in the following financial year then it should be deducted in the rate setting statement clearly shown as a separate line item.

3. Procedures for Determining the Opening and Closing Funds

3.1 Summarise Net Current Assets

An initial step is to prepare a summary of all current assets and current liabilities brought forward from the previous financial year. If actual amounts are unavailable, then estimates may be used. The use of estimates has to be clearly disclosed and reasonable efforts should be made to ensure they are as accurate as possible. Estimates may occur for items such as accruals, creditors, stock on hand and prepayments.

In the following table the actual closing balances of current assets and current liabilities are used to determine the net current assets (opening balance) for the following period budget.

Shire Of XYZ
Net Current Assets

	201Z Budget $	201Y Estimated Actual $
Current Assets		
Cash - Unrestricted	425,639	22,895
Cash - Restricted Reserve	6,289,693	5,162,318
Cash - Restricted Unspent Grants	0	1,566,637
Cash - Unspent Loans	0	30,000
Investments	0	190,000
Trade and Other Receivables	942,492	503,587
Inventories	500,601	256,313
Inventories - Land Held for Resale	0	424,393
	8,158,425	8,156,143
Less: Current Liabilities		
Sundry Creditors	(1,569,087)	(986,730)
Accrued Interest on Debentures	0	(71,652)
Accrues Salaries and Wages	0	(67,913)
Current Loan Liability	(91,592)	(83,612)
Current Employee Benefits Provision	(523,333)	(823,783)
	(2,184,012)	(2,033,690)
Net Current Asset Position	**5,974,413**	**6,122,453**

3.2 Calculation of Surplus/(Deficit) in the Annual Budget

The net current assets figure calculated above needs to be adjusted for relevant r. 31 and r. 32 items, already included in the annual budget to avoid double counting and any other adjustments in the table under 2.4 above. This involves:

- deducting all cash reserves as these are restricted by section 6.11 of the Act,
- deducting restricted grants and contributions that will **not** be used in the following year,
- deducting land held for resale inventory amount if it is not expected to be sold in the budget year,
- deducting loans that are proposed to remain unspent at the end of the financial year,
- deducting loan repayments from clubs/institutions from accruals,
- adding back interest-bearing liabilities disclosed as a current liability. This is required to ensure that current loan borrowings are not included twice as it is usually already included in the rate setting statement,
- adding back cash backed leave reserve or the value of leave already budgeted to avoid the amount being used twice in the calculations. This may only be added back if the leave provisions have been included in the calculation.

Note: Deciding what portion of leave provisions to 'add back' should be carefully considered in terms of what is already funded in the budget or can be funded from a cash reserve.

Consideration would need to be given to:

- Whether annual leave is funded through 52 weeks of budget for salaries and wages for each employee and the extent to which periods of extended leave are funded;
- Whether relief staff are engaged and how that cost is funded;
- The likelihood of large leave accruals being paid out on termination

Long service leave provision is calculated in accordance with AASB 119; a calculation based on the present value of probable future cash flows relevant to each employee. The provision includes a calculation for employees with less than 7 years continuous service and who would have no legal claim to leave until after that period of service is achieved. The accumulated value of this portion of the provision would not require funding.

It is stressed that if this is not assessed correctly, a funding shortfall may occur or the calculated budget deficiency may be incorrect.

The above adjustments result in either a surplus as a source of funds, or a deficit to be funded from rates as part of net opening and closing funds.

Determination of the carried forward figure for the annual budget is calculated from the estimated annual financial statements. This then becomes the brought forward surplus or deficit (opening funds) in the annual budget rate setting statement.

To accurately determine the June 30 carried forward surplus or deficit (closing funds), local governments are encouraged to create a budget statement of financial position and a budget statement of equity. The creation of these statements (while not prescribed) helps to ensure that a realistic estimate of the surplus or deficit is being carried forward to 30 June of the budget financial year.

Shire Of XYZ
Surplus/Deficit

	201Z Budget $	201Y Estimated Actual $
Net Current Assets Position	**5,974,413**	**6,122,453**
Less: Cash - Restricted Reserves	(6,289,693)	(5,162,318)
Less: Cash - Restricted Grants (used in future years)	0	(70,000)
Less: Land Held for Resale (sales in future years)	0	(424,393)
Less: Unspent Loans	0	(30,000)
Add Back: Current Long Term Borrowings	91,592	83,612
Add Back: Leave Reserve Cash Backed **Or**; Proportion of provisions already funded	223,688	644,160
Estimated Surplus/(Deficiency) c/fwd	**0**	**1,163,514**

The estimated surplus/(deficiency) c/fwd in the 201Y actual column represents the surplus (deficit) brought forward as at 1 July 201Y.

The estimated surplus/(deficiency) c/fwd in the 201Z budget column represents the surplus (deficit) carried forward as at 30 June 201Z.

3.3 Calculation of Surplus/(Deficit) in Annual Financial Report

Regulation 31(3)(a) requires the annual budget to include or be accompanied by notes containing a summary explaining the composition of the net current assets. Regulation 31(3)(b) requires the annual budget to include an explanation if the net current assets differs from the amount used in the rate setting statement.

Accordingly, local governments are encouraged to create a note that discloses how these amounts are determined which also provides information on any variance that has occurred between the prior year carried forward and the current year brought forward.

The following is a suggested template (also provided in the WA Local Government Accounting Manual) to aid in these calculations.

Shire Of XYZ
Surplus/Deficit

	201Y 30 June 201Y Actual Carried Forward $	201X 1 July 201X Actual Brought Forward $	201X 30 June 201X Actual Carried Forward $
Current Assets			
Cash - Unrestricted	22,895	850,416	850,416
Cash - Restricted Reserve	5,162,318	3,530,196	3,530,196
Cash - Restricted Unspent Grants	1,496,637	1,363,413	1,363,413
Cash - Restricted Unspent Grants to future year	70,000	261,679	261,679
Cash - Restricted Unspent Loans	30,000	0	0
Investments	190,000	0	0
Rates - Current	166,908	227,758	227,758
Sundry Debtors	240,499	277,002	277,002
GST Receivable	96,180	90,154	90,154
Inventories			
- Fuel and Materials	256,313	192,636	192,636
- Land Held for Resale	424,393	398,216	398,216
	8,156,143	7,191,470	7,191,470
Current Liabilities			
Sundry Creditors	(986,730)	(805,447)	(805,447)
Accrued Interest on Debentures	(71,652)	(32,191)	(32,191)
Accrues Salaries and Wages	(67,913)	(55,666)	(55,666)
Current Employee Benefits Provision	(823,783)	(924,356)	(924,356)
Current Loan Liability	(83,612)	(64,886)	(64,886)
	(2,033,690)	(1,882,546)	(1,882,546)
Net Current Assets	6,122,453	5,308,924	5,308,924

Shire Of XYZ
Surplus/Deficit

	201Y 30 June 201Y Actual Carried Forward $	201X 1 July 201X Actual Brought Forward $	201X 30 June 201X Actual Carried Forward $
Less:			
Cash - Restricted Reserves	(5,162,318)	(3,530,196)	(3,530,196)
Cash - Restricted Grants (used in future years)	(70,000)	(261,679)	(261,679)
Land Held for Resale (sales in future years)	(424,393)	(398,216)	(398,216)
Unspent Loans	(30,000)	0	0
Add Back:			
Current Loan Liability	83,612	64,886	64,886
Cash Back Employee Provisions			
Or; Proportion of provisions already funded	644,160	657,330	657,330
Surplus/(Deficit)	1,163,514	1,841,049	1,841,049

There is no difference to report between the audited brought forward position at 1 July 201X and the carried forward position as 30 June 201X.

Note: If there is a difference between the prior year 30 June carried forward and the 1 July brought forward figure, then an explanation of this difference must be given.

4. Rate Setting Statement

The rate setting statement is pivotal to determining the amount required to be made up from rates and whether a balanced, surplus or deficit budget is adopted. It has the features of an income statement, the cash flow statement and a capital works program. The financial resources required and applied are summarised in this one statement.

This statement contains values of net current assets carried forward from the previous financial year shown as the opening funds at 1 July and net current assets shown as closing funds at 30 June.

The opening funds form part of the calculation of the amount of the deficiency to be raised from rates as referred to in section 6.2(2)(c) of the Act. Given the statutory limits on general rates that can be imposed to make up the budget deficiency, it is important that it be calculated as accurately as possible to ensure that a valid budget is adopted.

The following example demonstrates the use of opening and closing funds in the rate setting statement. The calculation of opening funds is explained in detail in part 3 of this guideline.

Shire Of XYZ
Summarised Rate Setting Statement

	201Z Budget $	201Y Est. Actual $	201Y Budget $
Revenue	17,622,795	16,128,822	18,453,202
Expenses	(20,538,545)	(21,513,908)	(21,845,498)
Net Operating Excluding Rates	**(2,915,750)**	**(5,385,086)**	**(3,392,296)**
Non-Cash Revenue and Expense			
(Profit)/Loss on Asset Disposals	(91,795)	54,277	(2,284,581)
Movement non-current to current	0	2,077	0
Depreciation on Assets	7,200,000	6,907,407	7,100,000
Net Non-Cash Revenue and Expense	**7,108,205**	**6,963,761**	**4,815,419**
Capital Expenditure			
Property, Plant, Equipment, Infrastructure	(13,991,768)	(10,981,539)	(19,255,395)
Repayment of Debentures	(83,612)	(70,597)	(70,597)
Advances to Community Groups	0	(500,000)	(500,000)
Net Capital Expenditure	**(14,075,380)**	**(11,552,136)**	**(19,825,992)**
Capital Revenue			
Proceeds Disposal of Assets	602,000	759,429	5,904,712
Proceeds from New Debentures	320,000	2,027,644	2,188,452
Self-Supporting Loan Principal Income	25,399	24,393	24,393
Net Capital Revenue	**947,399**	**2,811,466**	**8,117,557**

Shire Of XYZ
Summarised Rate Setting Statement

	201Z Budget $	201Y Est. Actual $	201Y Budget $
Transfers			
Transfers to Reserves	(3,867,220)	(3,376,061)	(1,478,584)
Transfers from Reserves	2,739,845	1,743,939	2,447,854
Net Transfers	**(1,127,375)**	**(1,632,122)**	**969,270**
Capital Revenue			
Add: Est. Surplus/(Deficit) July 1 B/fwd*	1,163,514	1,841,049	1,290,473
Less: Est. Surplus/(Deficit) June 30 C/fwd*	0	1,163,514	0
Amount Required to be Raised from Rates	**(8,899,387)**	**(8,116,582)**	**(8,025,569)**

* Calculation of these figures is given in parts 3 and 5 of this guideline.

5. Limits on Deficit or Surplus Budgets

Section 6.34 of the Act places restrictions on the amount shown in the annual budget as being the amount it is estimated will be yielded by the general rate, unless the Minister otherwise approves. The amount to be yielded by the general rate is not to:

- be more than 110% of the amount of the budget deficiency, or
- be less than 90% of the amount of the budget deficiency.

In other words, a local government cannot (without the Minister's approval) adopt an annual budget with a surplus or deficit of more than 10% of the budget deficiency.

Using the information from the Rate Setting Statement given earlier, the percentage to be derived from rates compared with the total budget deficiency is calculated. It will be noted from that statement that the amount to be made up from rates is $8,899,387.

If the local government does not propose to adopt a balance budget with $8,899,387 in general rates, it has the discretion to impose rates within the range of $8,009,449 to $9,789,325 without obtaining Ministerial approval. This is detailed in the following table:

Total Budget Deficiency		$8,899,387
Amount Required to be Raised from Rates	Balance Budget	$8,899,387
Lower 90% limit (10% Deficit Budget)	Less 10% $889,938	$8,009,449
Upper 110% limit (10% Surplus Budget)	Plus 10% $889,938	$9,789,325

Assuming that the local government proposed a 10% surplus budget, then the last three lines of the Rate Setting Statement would disclose:

	201Z Budget $	201Y Est. Actual $	201Y Budget $
Add: Est. Surplus/(Deficit) July 1 B/fwd	1,163,514	1,841,049	1,290,473
Less: Est. Surplus/(Deficit) June 30 C/fwd	889,938	1,163,514	0
Amount Required to be Raised from Rates	(9,789,325)	(8,116,582)	(8,025,569)

If the amount required to be raised from rates is outside of the 90%–110% statutory limits, Ministerial approval must be obtained **before** adopting the annual budget. If this is adopted without that approval, the budget would be considered to be invalid and rates challenged in the State Administrative Tribunal under section 6.82 of the Act.

6. Opening and Closing Funds – Budget Review

Local Government (Financial Management) Regulations r. 33A require a Local Government to conduct a budget review to consider their financial performance in the period beginning on 1 July and ending no earlier than 31 December in that financial year.

This is the only statutory budget review that has to be undertaken. However, it is extremely important for a local government to review the budget immediately following the annual financial statements being completed and audited. Very often the estimated carried forward figure in the budget will differ from the audited annual financial statements carried forward figure and this should be adjusted by a budget variation adopted by Council as early as possible in the current financial year.

These guidelines are also available on the Department's website at www.dlgc.wa.gov.au

Government of **Western Australia**
Department of **Local Government and Communities**

Local Government Advisory Hotline
1300 762 511
Email: lghotline@dlgc.wa.gov.au
8.30am–5.00pm, Monday to Friday

About the Guideline series

This document and others in the series are intended as a guide to good practice and should not be taken as a compliance requirement. The content is based on Department officer knowledge, understanding, observation of, and appropriate consultation on contemporary good practice in local government. Guidelines may also involve the Department's views on the intent and interpretation of relevant legislation.

All guidelines are subject to review, amendment and re-publishing as required. Therefore, comments on any aspect of the guideline are welcome. Advice of methods of improvement in the area of the guideline topic that can be reported to other local governments will be especially beneficial.

For more information about this and other guidelines, contact the Local Government Regulation and Support Branch at:

Department of Local Government and Communities
Gordon Stephenson House, 140 William Street, Perth WA 6000
GPO Box R1250, Perth WA 6844
Telephone: (08) 6551 8700 Fax: (08) 6552 1555
Freecall (Country only): 1800 620 511
Email: info@dlgc.wa.gov.au Website: www.dlgc.wa.gov.au

Translating and Interpreting Service (TIS) – Tel: 13 14 50