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# Declassification of Business Activities from Financial Statements

*Responsible Officer: Group Manager Corporate and Commercial (Geoff Ward)*

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## Recommendation

That Council resolve to:

1. Declassify the business activities of Land development and Commercial properties;
2. That the declassification be effective from 1 July 2022;
3. Following declassification, only Water activities will be reported in the Special Purpose Financial Statements.

## Background

In July 1997 the Office of Local Government (formally 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.

The publication set out a small number of activities which were 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 other functions to determine whether or not it had any other activities that should be classified as a 'business'.

The publication lists a number of questions to help assist in the determination of business activities. These include but are not limited to:

- Is the activity intended to make a profit?  
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, 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 criteria 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.

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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 was set as a rule of thumb measure of the significance of those activities for the purpose of applying a corporatisation model and pricing requirements.

Council in determining which business units would be created was then required to prepare Special Purpose Financial Reports detailing the operations of the business unit.

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

- Land Development;
- Commercial Properties;

### **Business activities to be declassified**

Council has three business activities being Water, Land Development and Commercial Properties. The current process of reporting on the existing business activities 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.

It is contended that the current classification of business activities is no longer relevant to the operation of Council due to a number of significant changes.

Each of the activities proposed to be declassified are reported to Council through the formal Quarterly Budget Review process.

Property Development – Council does not actively seek out new land developments, with Perradenya being the only land development that Council has been involved in. Construction on six stages has taken place over the past 22 years. Revenue is only generated when a stage is sold, which means that it is not uncommon for the development not to generate any revenue for up to 5 years between stages. As this development is nearing completion and Council does not actively compete in the development business, it is proposed to declassify.

Commercial Properties – Council has divested the majority of its commercial properties over the past ten years, with the last investment property (Carrington St) being sold in November 2021. Income generated from the remaining rural properties is less than \$60,000 annually.

By eliminating the Category 2 business activities 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 reduce an area of great complexity from the interpretation of the result of the business activities.

Further, it is not uncommon for Councils to elect to declassify business activities. For example, in 2014, Port Stephens Council declassified the following 4 Category 2 business activities:

- Property development
- Holiday parks
- Civil works
- Newcastle airport

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The declassification is to be effective from 1 July 2022, with Category 1 'Business activity' - Water to be the only activity reported in the Special Purpose Financial Statements.

### **Finance**

Each of the activities have approved annual budgets, with revenue and expenditure information reported to Council through Quarterly Budget Reviews and the annual Preliminary Year End report. The declassification of 'Business activities' in the Special Purpose Financial Statements will have no monetary effect on the budget.

### **Legal**

Contained in the body of the report.

### **Consultation**

Consultation has been undertaken with the Office of Local Government, Council's external auditors and staff from several General-Purpose Councils.

### **Conclusion**

The declassification of the Category 2 business activities will assist in the timely and cost-effective completion of Council's financial statements.