2019/20 Annual Financial Report Audit Findings

Summary

The Auditor General in the Auditor's Report for the 2019/20 financial year has identified that the Asset Sustainability and Operating Surplus Ratios are below the Department of Local Government, Sport and Cultural Industries (DLGSCI) ratio standard for the past 3 years and last 2 years respectively.

The Local Government Act, Section 7.12A(4) requires local governments to examine the audit report it receives and implement appropriate action in respect to the significant matters raised. A report addressing the significant matters identified in the audit report must be prepared and then considered by the Audit Committee before being adopted by Council.

This report has been prepared to meet the above requirements of the Local Government Act.

Requirement to Report on Significant Audit Findings

Section 7.12A(4) of the Local Government Act 1995 requires that a local government must:

(a) *prepare a report addressing any matters identified as significant by the auditor in the audit report, and stating what action the local government has taken or intends to take with respect to each of those matters; and*

(b) *give a copy of that report to the Minister within 3 months after the audit report is received by the local government.*

Significant Matter Identified by the Auditor General

The Audit Report prepared by the Auditor General on the 2019/20 Annual Financial Statements identified the following significant adverse trends:

(a) *Asset Sustainability Ratio as reported in Note 37 of the annual financial report is below the Department of Local Government, Sport and Cultural Industries' standard of 0.8 for the last three years; and*

(b) *Operating Surplus Ratio as reported in Note 37 of the annual financial report is below the Department of Local Government, Sport and Cultural Industries' standard of zero for the last two years.*

Implications

The implications to the City's financial position are:

Asset Sustainability Ratio:
This ratio measures the extent to which assets are being renewed or replaced compared to the amount consumed (i.e. depreciated).

While there is no short term impact, should this trend continue in the long term there is a risk that the condition of assets will deteriorate to the point that they do not adequately meet the needs of the community. This is due to not providing sufficient investment into the renewal or replacement of assets, compared to the rate they are wearing out.

Operating Surplus Ratio:
This ratio measures the local government's ability to cover its operational costs and have revenues available for capital funding and other purposes.

As the City's operational costs (including depreciation) are greater than the operating revenues, the ratio is below zero and does not achieve the Department's benchmark. In the short term there is little financial affect as the cash surplus (i.e. excluding depreciation which is a non-cash expense) is adequate to meet the City's budgeted needs. However, the long term effect of an ongoing operating deficit negatively impacts the City's funding capacity for either capital expenditure, being able to set aside funds into reserves, or to reduce debt in the future.

Management Comment

The Audit General's Report has not identified any non-compliance with the Local Government Act or Australian Accounting Standards in the 2019/20 Annual Financial Report; but does identify two ratios that are below a benchmark used as a guide by the Department of Local Government, Sport and Cultural Industries.

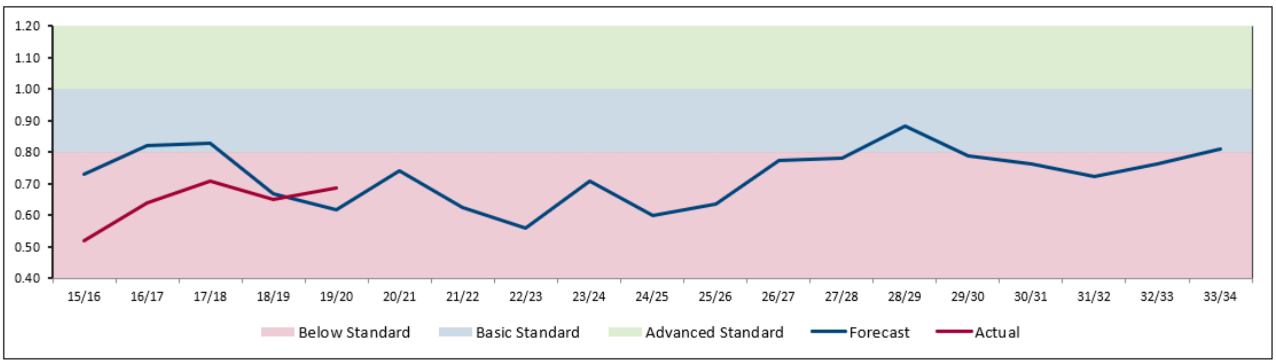
The Ratios are calculated using the following formula:

Asset Sustainability Ratio = Capital Renewal and Replacement Expenditure / Depreciation

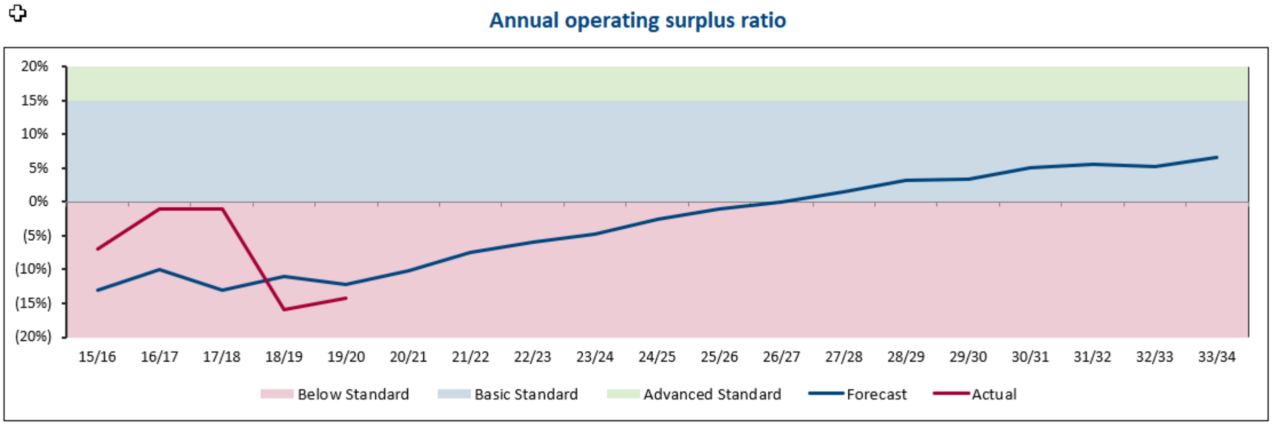
Operating Surplus Ratio = Operating Revenue – Operating Expenditure / Own Source Operating Revenue

The following are extracts from the Integrated Financial Plan 2019/20 to 2033/34 adopted by Council in May 2019 (updated with the 2019/20 Actual) showing improvements in both ratios in the outer years:

Asset sustainability ratio



	15/16	16/17	17/18	18/19	19/20	20/21	21/22	22/23	23/24	24/25	25/26	26/27	27/28	28/29	29/30	30/31	31/32	32/33	33/34
Forecast	0.73	0.82	0.83	0.67	0.62	0.74	0.63	0.56	0.71	0.60	0.63	0.78	0.78	0.88	0.79	0.76	0.72	0.76	0.81
Actual	0.52	0.64	0.71	0.65	0.69														



	15/16	16/17	17/18	18/19	19/20	20/21	21/22	22/23	23/24	24/25	25/26	26/27	27/28	28/29	29/30	30/31	31/32	32/33	33/34
Forecast	(0.13)	(0.10)	(0.13)	(0.11)	(0.12)	(0.10)	(0.07)	(0.06)	(0.05)	(0.02)	(0.01)	(0.00)	0.02	0.03	0.03	0.05	0.06	0.05	0.07
Actual	(0.07)	(0.01)	(0.01)	(0.16)	(0.14)														

The Asset Sustainability Ratio is significantly affected by the amount of depreciation expense in each year. In 2019/20 this totalled $14.4M. The accuracy of the amount of depreciation calculated continues to improve as the City's Asset Management team refines the infrastructure asset database information on condition, life and replacement dates.

The following is the trend on both ratios from 2016/17 to the 2020/21 Budget:

Ratio	DLGSCI Target	Actual				Budget
		2017	**2018**	**2019**	**2020**	**2021**
Asset Sustainability	Greater than 0.80	0.643	0.738	0.670	0.688	1.350
Operating Surplus	Greater than Zero	(0.005)	0.001	(0.151)	(0.143)	(0.170)

Note:
The Asset Sustainability Ratio budgeted for 2021 of 1.35 meets the DLGSCI standard of being greater than 0.80.

<u>Action Taken or Intended to be Taken</u>

To improve these ratios the City needs to:

Asset Sustainability Ratio -	Allocate more capital expenditure on the renewal or upgrade of existing assets. (Which it has done in 2021)
Annual Operating Surplus Ratio -	Either reduce operating expenditure and/or increase operating revenue.

There can be no short term actions taken without incurring significant negative impacts to the community through either unreasonable rate increases or a decrease in the level of services. Based on the assumptions underlying the City's 15 year Integrated Financial Plan the above ratios will improve in the long term. With careful financial management, relying on modest and affordable rate increases, management's continuous review of operational expenditure to ensure value for money and achieving savings through operational efficiencies; both ratios in the long term forecasts will either match or exceed the Department's benchmarks.

To achieve the above the City will continue to:

a) Monitor all financial ratios against the Department's benchmarks;
b) Maximise when possible within the budget constraints, expenditure on the renewal or upgrade of existing assets; and
c) Identify additional revenue sources and savings through operational efficiencies in its long term financial plans and annual budgets.

Completion or Proposed Completion Date

Based on the 15 year Integrated Financial Plan 2019/20 to 2033/34 adopted by Council in May 2019 the Asset Sustainability Ratio and Operating Surplus Ratio will improve in the long term.