REPORT ON MATTERS OF SIGNIFICANCE - 2017/18 AUDIT REPORT

Background

As part of the Statutory Audit process of the Annual Financial Statements, the OAG is required to report of any matters relating to Legal and Regulatory Requirements that come to their attention. For the City's Annual Financial Statement for the year ended 30 June 2018, the OAG identified the City was not compliant with the Current Ratio and the Asset Sustainability Ratio standard set by the DLGSCI for the past three years, which was highlighted in their Independent Auditor's Report dated 15 November 2018

This adverse position was presented to the Audit and Risk Committee on the 13 November 2018 and Council on the 27 November 2018.

As required by the Local Government Act section 7.12A (4), this non-compliance, was reported to the Audit and Risk Committee on the 13 August 2019 and subsequently to Council on 27 August 2019 (Reference CS01 – 08/19), attached for your perusal.

Detail

Please find below specific details of the two adverse ratios and the reasons explaining why the City is unable to meet the set parameters.

1. **Current Ratio**

Description	**2017/18**	**2016/17**	**2015/16**	**Benchmark**
Current Ratio	0.85:1	0.86:1	0.88:1	**1.00:1**

Extract from the DLGSCI Guidelines on Ratio's:

"Current Ratio = (Current Assets MINUS Restricted Assets) /
(Current Liabilities MINUS Liabilities Associated with Restricted Assets)

Purpose: This is a modified commercial ratio designed to focus on the liquidity position of a local government that has arisen from past year's transactions.

Standards: The standard is not met if the ratio is lower than 1:1 (less than 100%) The standard is met if the ratio is greater than 1:1 (100% or greater) A ratio less than 1:1 means that a local government does not have sufficient assets that can be quickly converted into cash to meet its immediate cash commitments. This may arise from a budget deficit from the past year, a Council decision to operate an overdraft or a decision to fund leave entitlements from next year's revenues.

This ratio is used to determine if a Local Government (LG) has sufficient assets to meet its short term commitments. A ratio of less than 1 would mean that the LG may struggle to meet its short term commitments."

The City does not believe the above generalised view is correct as it deems "restricted" cash as un-accessible. While it is acknowledged that the City's Special Purpose Cash Backed Reserves are set aside for a specific purpose, the City has a detailed cash flow forecasting model in place which tracks all operating and capital inflows and outflows including the realisation of investments and transfers from/ to restricted reserves. It has managed its payment commitments without any recorded delay's in its payment cycles for creditor and staff commitments.

The City's cash holdings (restricted and un-restricted) have been progressively improving as noted below:

2014/15	2015/16	2016/17	2017/18
$316.9m	$338.7m	$340.8m	$363.5m

The City has a deliberate strategy to improve its Cash Backed Reserves Balances to enable financially sustainable and responsible management of the deliverability of large multi-year projects and long term liabilities. This strategy enables the City to ensure that it has the capacity to manage future General Rate rises/declines.

An additional benefit of having the cash holdings in Reserves is that interest income from investments can be maximised providing an additional income stream thereby reducing the need to raise additional funds from General Rates.

It should be noted that Council has the ability to transfer funds from a number of restricted reserves (e.g. Strategic Project/Initiatives Reserve) to unrestricted cash holdings should the need arise to meet cash shortfalls.

Nevertheless as it stands the City does not meet the DLGSI guidelines. However as noted above, this is by choice to ensure the City has appropriate reserves which will help smoothen General Rate rises/declines in the future.

2. **Asset Sustainability Ratio**

Description	2017/18	2016/17	2015/16	Benchmark
Asset Sustainability Ratio	0.34:1	0.32:1	0.45:1	**0.90:1**

The DLGSCI Asset Management Framework and Guidelines publication provides the following explanation in respect to the Asset Sustainability Ratio (**ASR**):

> *"If capital expenditure on renewing or replacing assets is at least equal to depreciation on average over time, then the local government is ensuring the value of its existing stock of physical assets is maintained. If capital expenditure on existing assets is less than depreciation then, unless a local government's overall asset stock is relatively new, it is likely that it is underspending on renewal or replacement."*

A large percentage of the City's assets are in new to very good condition with approximately 85% of the total asset base at or below condition two (a rating of '0' represents a new asset and a '10' represents an asset that has failed). Less than 1% of the asset base is at or above condition eight, which represents assets that require intervention.

With the City's current mix of old and new assets and continued high growth, a lower than average ASR is expected, and the current condition of assets and level of renewal expenditure confirms this position. As the stock ages and renewal expenditure incrementally increases the ratio will increase, however continued growth may keep it relatively lower than the industry standard.

Taking a long term view, the level of asset stock and renewal demand necessitates the development of strategies to address the future impact and ensure that the City can continue to grow and maintain its assets in a financially sustainable manner. Given that renewal expenditure is lower than the depreciation being charged and that certain years' experience significant spikes in demand, a specific Asset Renewal Reserve has been established.

We further note that the issue of adverse Ratio's is a Council wide issue and were discussed at the Local Government Professional's workshop held on the 23rd August 2019 at City of Kwinana.

At this meeting the Department representative acknowledged the issue required reviewing and have commenced the consultation process with the West Australian Local Government Association (WALGA) and the Local Government Professionals Australia WA.

We await the outcome of these consultations.