

File Ref: 19/485026
Enquiries: Bimsara Pathirathna – 9405 5563

11 December 2019

Hon David Templeman
Minister for Local Government, Heritage, Culture and the Arts
7th Floor, Dumas House
2 Havelock Street
WEST PERTH WA 6005

Dear Minister

MATTERS OF SIGNIFICANCE - 2018/19 Audit Report

Under section 7.12A(4) (a) and (b) of the *Local Government Act 1995*, the City is required to 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 give a copy of that report to the Minister within 3 months after the audit report is received by the local government.

The statutory audit of the City of Wanneroo's annual financial statements for the year ended 30 June 2019 was completed by the Office of the Auditor General (OAG) and reported two significant adverse trends on their audit report dated 22 November 2019.

The OAG noted that the City's Current Ratio and Asset Sustainability Ratio were below the standard set by the Department of Local Government, Sport and Cultural Industries (DLGSCI) for the last three years.

The attached Council report (**attachment 2**) addressing this matter and the actions the City intends to take in respect of those adverse trends was presented to the Audit and Risk Committee on the 19 November 2019 and Council on the 3 December 2019.

Please find the report (**attachment 1**) addressing the above matter for your records. This report will be published on our website as required by the *Local Government Act 1995*, section 7.12A (5).

Yours sincerely



DANIEL SIMMS
CHIEF EXECUTIVE OFFICER

Attachments:

1. Report on Matters of Significance – 2018/19 Audit Report
2. Council Report SCS03-12/19 – Report on Matters of Significance highlighted in the 2018-19 Audit Report
3. OAG Independent Auditor's Report 2018/19

cc: Narrell Lethorn, Director Industry and Sector Regulation, Department of Local Government, Sport and Cultural Industries

Report to the Minister for Local Government, Heritage, Culture and the Arts on Matters of Significance noted in the Independent Auditor's Report 2018/19

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 2019, 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 22 November 2019

This adverse position was presented to the Audit and Risk Committee on the 19 November 2019 and Council on the 3 December 2019.

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.

Current Ratio				
	2018/19	2017/18	2016/17	Benchmark
Current Ratio	0.80:1	0.89:1	0.89:1	1.00:1

Extract from the DLGSCI Guidelines on Ratio's:

*“Current Ratio =
$$\frac{(\text{Current Assets MINUS Restricted Assets})}{(\text{Current Liabilities MINUS Liabilities Associated with Restricted Assets})}$$
”*

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 delays 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	2018/19
Restricted	\$293.6m	\$305.2m	\$340.8m	\$361.8m	\$358.3m

Unrestricted	\$8.9m	\$14.4m	\$18.6m	\$12.7m	\$21.4m
Total	\$302.5m	\$319.6m	\$359.4m	\$374.5m	\$379.7m

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 multiyear projects and long term liabilities. This strategy enables the City to ensure that it has the capacity to manage future General Rate rises/ declines.

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.

The City is currently seeking to review its Financial (Cash Backed) Reserves Policy to allow for more flexibility in calculating current ratio which will enable the City to meet the DLGSCI standards for future current ratio calculations.

Asset Sustainability Ratio

	2018/19	2017/18	2016/17	Benchmark
Asset Sustainability Ratio	0.44:1	0.34:1	0.32:1	0.90:1

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

$$\text{Asset Sustainability Ratio} = \frac{\text{Capital Renewal and Replacement Expenditure}}{\text{Depreciation}}$$

"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 2 (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 8, 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 should increase, however continued growth may keep it relatively lower than the industry standard.

Taking a long-term outlook, 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.

SCS03-12/19 Report on Matters of Significance highlighted in the 2018-19 Audit Report

File Ref: 38026 – 19/459713
 Responsible Officer: Director Corporate Strategy & Performance
 Disclosure of Interest: Nil
 Attachments: 1

Issue

To consider the matters identified as significant in the Independent Auditor's Report for the year ended 30 June 2019 by the Office of the Auditor General (**OAG**). Specifically, adverse trends of some of the reportable Ratios which were calculated in-line with reporting requirements as specified in the guidelines issued by the Department of Local Government, Sports and Cultural Industries (**DLGSCI**).

The matters require specific action and disclosure as per section 7.12A(4) and (5) of the *Local Government Act 1995* (the **Act**).

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 2019, 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 22 November 2019 (**Attachment 1**).

Under the *Local Government Act 1995* section 7.12A(4) and (5), Duties of local government with respect to the Act audits:

- (4) *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.*
- (5) *Within 14 days after a local government gives a report to the Minister under subsection (4)(b), the CEO must publish a copy of the report on the local government's official website.*

Detail

As indicated above, the OAG has highlighted under the heading, 'Report on Other Legal and Regulatory Requirements' in the Independent Auditor's Report dated 22 November 2019 that the Current Ratio and the Asset Sustainability Ratio have been below the DLGSCI set standard for the past three years.

The adverse position has been presented to the Audit and Risk Committee on the 19 November as part of the 2018/19 Annual Financial Statements. Explanation of this position is detailed below.

Description	2018/19	2017/18	2016/17	Benchmark
Current Ratio	0.80:1	0.89:1	0.89:1	1.00:1

Extract from the DLGSCI Guidelines on Ratio's:

$$\text{Current Ratio} = \frac{(\text{Current Assets MINUS Restricted Assets})}{(\text{Current Liabilities MINUS Liabilities Associated with Restricted Assets})}$$

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 delays 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	2018/19
Restricted	\$293.6m	\$305.2m	\$340.8m	\$361.8m	\$358.3m
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Total	\$302.5m	\$319.6m	\$359.4m	\$374.5m	\$379.7m

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 multiyear projects and long term liabilities. This strategy enables the City to ensure that it has the capacity to manage future General Rate rises/ declines.

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.

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

Description	2018/19	2017/18	2016/17	Benchmark
Asset Sustainability Ratio	0.44:1	0.34:1	0.32:1	0.90:1

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

$$\text{Asset Sustainability Ratio} = \frac{\text{Capital Renewal and Replacement Expenditure}}{\text{Depreciation}}$$

"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 2 (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 8, 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 should increase, however continued growth may keep it relatively lower than the industry standard.

Taking a long-term outlook, 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.

Consultation

Nil

Comment

On receipt of this report, the Chief Executive Officer (**CEO**) must notify the Minister of the action taken and ensure the same is published on the City's website within 14 days of issuance of the letter.

Statutory Compliance

Local Government Act 1995

Local Government (Audit) Regulations 1996

Strategic Implications

The proposal aligns with the following objective within the Strategic Community Plan 2017 – 2027:

“4 Civic Leadership

4.2 Good Governance

4.2.1 Provide transparent and accountable governance and leadership”

Risk Management Considerations

Risk Title	Risk Rating
Financial Management	Moderate
Accountability	Action Planning Option
Executive Management Team	Manage

The above risk relating to the issue contained within this report has been identified and considered within the City's Corporate Risk Register. Action plans have been developed to manage this risk to improve the existing management systems.

Policy Implications

Nil

Financial Implications

Nil

Voting Requirements

Simple Majority

Recommendation

That Council:-

- 1. APPROVES this report identifying reasons for matters identified as significant by the Office of the Auditor General in their Independent Auditors Report dated 22 November 2019; and**
- 2. REQUESTS the Chief Executive Officer to submit a report to the Minister for Local Government, Sports and Cultural Industries commenting on the reasons for the deficiencies noted by the Office of the Auditor General and actions to be taken, and publish this report on the City of Wannon's website within 14 days of submitting the report to the Minister.**

Attachments:

- 1. OAG Independent Auditor's Report (Audit opinion) 30 June 2019 19/464670*



Auditor General

INDEPENDENT AUDITOR'S REPORT

To the Councillors of the City of Wanneroo

Report on the Audit of the Financial Report

Opinion

I have audited the annual financial report of the City of Wanneroo which comprises the Statement of Financial Position as at 30 June 2019, the Statement of Comprehensive Income by Nature or Type, Statement of Comprehensive Income by Program, Statement of Changes in Equity, Statement of Cash Flows and Rate Setting Statement for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information, and the Statement by the Chief Executive Officer.

In my opinion the annual financial report of the City of Wanneroo:

- (i) is based on proper accounts and records; and
- (ii) fairly represents, in all material respects, the results of the operations of the City for the year ended 30 June 2019 and its financial position at the end of that period in accordance with the *Local Government Act 1995* (the Act) and, to the extent that they are not inconsistent with the Act, Australian Accounting Standards.

Basis for Opinion

I conducted my audit in accordance with Australian Auditing Standards. My responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Report* section of my report. I am independent of the City in accordance with the *Auditor General Act 2006* and the relevant ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants* (the Code) that are relevant to my audit of the annual financial report. I have also fulfilled my other ethical responsibilities in accordance with the Code. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Emphasis of Matter – Basis of Accounting

I draw attention to Note 1 to the annual financial report, which describes the basis of accounting. The annual financial report has been prepared for the purpose of fulfilling the City's annual financial reporting responsibilities under the Act. Regulation 16 of the Local Government (Financial Management) Regulations 1996 (Regulations), does not allow a local government to recognise some categories of land, including land under roads, as assets in the annual financial report. My opinion is not modified in respect of this matter.

Responsibilities of the Chief Executive Officer and Council for the Financial Report

The Chief Executive Officer (CEO) of the City is responsible for the preparation and fair presentation of the annual financial report in accordance with the requirements of the Act, the Regulations and, to the extent that they are not inconsistent with the Act, Australian Accounting Standards. The CEO is also responsible for such internal control as the CEO determines is necessary to enable the preparation of a annual financial report that is free from material misstatement, whether due to fraud or error.

In preparing the annual financial report, the CEO is responsible for assessing the City's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the State government has made decisions affecting the continued existence of the City.

The Council is responsible for overseeing the City's financial reporting process.

Auditor's Responsibility for the Audit of the Financial Report

The objectives of my audit are to obtain reasonable assurance about whether the annual financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the annual financial report.

As part of an audit in accordance with Australian Auditing Standards, I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the annual financial report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the CEO.
- Conclude on the appropriateness of the CEO's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the City's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the annual financial report or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report, as we cannot predict future events or conditions that may have an impact.
- Evaluate the overall presentation, structure and content of the annual financial report, including the disclosures, and whether the annual financial report represents the underlying transactions and events in a manner that achieves fair presentation.

I communicate with the Council and the CEO regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

Report on Other Legal and Regulatory Requirements

In accordance with the Local Government (Audit) Regulations 1996 I report that:

- (i) In my opinion, the following material matters indicate significant adverse trends in the financial position of the City:
 - a. The Current Ratio has been below the Department of Local Government, Sport and Cultural Industries (DLGSCI) standard for the past 3 years.
 - b. The Asset Sustainability Ratio has been below the DLGSCI standard for the past 3 years.
- The financial ratios are reported in Note 22 of the annual financial report.
- (ii) All required information and explanations were obtained by me.
 - (iii) All audit procedures were satisfactorily completed.
 - (iv) In my opinion, the asset consumption ratio and the asset renewal funding ratio included in the annual financial report were supported by verifiable information and reasonable assumptions.

Other Matter

The financial ratios for 2017 in Note 22 of the annual financial report were audited by another auditor when performing their audit of the City for the year ending 30 June 2017. The auditor expressed an unmodified opinion on the annual financial report for that year.

Matters Relating to the Electronic Publication of the Audited Financial Report

This auditor's report relates to the annual financial report of the City of Wanneroo for the year ended 30 June 2019 included on the City's website. The City's management is responsible for the integrity of the City's website. This audit does not provide assurance on the integrity of the City's website. The auditor's report refers only to the annual financial report described above. It does not provide an opinion on any other information which may have been hyperlinked to/from this annual financial report. If users of the annual financial report are concerned with the inherent risks arising from publication on a website, they are advised to refer to the hard copy of the audited annual financial report to confirm the information contained in this website version of the annual financial report.



CAROLINE SPENCER
AUDITOR GENERAL
FOR WESTERN AUSTRALIA
Perth, Western Australia
22 November 2019