CENTRAL TABLELANDS ALLIANCE (CTA) AUDIT and RISK IMPROVEMENT COMMITTEE (ARIC)

MINUTES

Wednesday 4 November 2020

Lithgow City Council – Financial Statement meeting 10.00 am to 11.00am

Attendees

Voting	
Neil Maltby	Independent Member & Chair
Phillip Burgett	Independent Member
Phil Ross	Independent Member
Wayne McAndrew, Deputy Mayor	Lithgow City Council
Steve Ring, Councillor	Lithgow City Council
Non-Voting	
Craig Butler, General Manager	Lithgow City Council
Ross Gurney, Chief Financial and Information Officer	Lithgow City Council
Rhiannan Whiteley, Secretariat	Lithgow City Council
Gabriel Fanople	Crowe (External Audit Agent)

Apologies

Ray Thompson, Mayor	Lithgow City Council

1. Financial Statements

Chair Neil Maltby welcomed everyone to the meeting

Councillor Steve Ring put in an apology for the Mayor, Ray Thompson.

It is noted that there was no representative from the contract Audit office. CFIO confirmed he spoke with Gabriel Fanople from Crowe (contract auditor) – we need to be clear on what the timeline is for the completion of the audit and having the financial statements completed on time within the extended November deadline and the financial statements being presented to the 23 November meeting.

CFIO provided a summary of financial statements:

Council experienced an unusually challenging operating environment throughout the 19/20 year. Similar to other councils costs have been rising faster than the revenue in recent years making it increasingly difficult to deliver a balanced operating result.

In 2019/20 council also dealt with a number of natural disasters followed by the Covid-19 pandemic which resulted in additional costs, less income and lower cash flows. Council's income was impacted by the COVID-19 pandemic, mainly commercial rent and user fees. In addition Council incurred costs related to natural disasters particularly bushfires and floods. The COVID-19 economic environment and delays to water billing had an impact on Council's cash receipts resulting in higher debtor balances and the utilisation of internal reserves to meet cash needs. With the exception of the 2016/17 year, in recent years Council has not achieved the key OLG financial performance measure of a balanced operating result before capital grants. In 2019/20 Council's operating deficit before capital grants was ($2.6 million) compared with a ($1.78M) deficit in the prior year. The recently updated Long Term Financial Plan sets out a pathway to achieving this key measure of financial sustainability in future years. In the 2019/20 year, Council achieved 7/10 OLG Financial and Asset performance ratio benchmarks. Council met the infrastructure backlog ratio benchmark for the first time and the buildings infrastructure renewal ratio benchmark for the first time in four years. There have been some positives in a very difficult year.

CFIO highlighted some of the key points on the income statement:

- Had an expected increase in ordinary rates income due to the rate peg and there was some small growth in the rating base.
- Annual charges income was stable.
- No increase in water, sewer or waste charges in the Operational Plan.
- Reasonably steady water usage - $82,000 increase in water supply user charges.
- Increase in revenue from private works – mainly due to NBN related works.
- One of the key factors with revenue is the impact of record low interest rates and lower reserve balances on interest and investment revenue. There was a significant decrease of $325,000 and that impact is continuing into this financial year with another reduction in interest rates.
- We had an increase in operating grants, financial assistance grants increasing and also disaster relief grants. We had lower capital grants with fewer grant funded capital projects and other revenue increased with receipt of a $500,000 RFS Section 44 claim. In total, income increased by 3%, $1.42 million. It didn't keep up with expenditure which was up by 8.5%, mainly attributable to the natural disaster costs and an ongoing increase in employee benefits and on costs. This is one of Council's biggest challenges in future years, containing employment costs. We expect employment costs to continue to increase in the current and following financial year with Council taking control of the Lithgow waste facility which had been contracted out so we will have our own staff running that which means additional staff. This will of course be offset by expenditure coming directly to Council. Also there are new positions in Water and Wastewater. We had no other new positions approved by Council this financial year but we do recognise that this is going to be an ongoing challenge to contain employment costs in future years. We have also implemented a strategy for delaying recruitment action for new and replacement roles for as long as practical.
- We had an increase in materials and contract costs which were particularly related to the bushfire and disaster relief works which were substantially funded from grant income.

- Borrowing costs increased which were mainly related to an adjustment for remediation liabilities.
- Significant increase in depreciation – renewals program and commissioning new assets for the road network and other structures.
- Decrease in other expenses which is attributable to some good savings we achieved with general insurance and reduction in donations / contributions and financial assistance together with a decrease in street lighting following the change to LED street lights.
- As mentioned 8.5% increase in expenses which is more than we had in additional income leading to a higher operating deficit before capital grants.

Chair, Neil Maltby asked the following question:

- With the increase in leave entitlements - are staff are being encouraged to take leave?
- CFIO advised that ELT are aware of the issue. With COVID, a lot of staff have cancelled their leave so we are following that up by reviewing the leave balance report on a regular basis and are encouraging staff to take leave, Council will be closing for a two-week shutdown at the end of the year.
- Council has improved and significantly reduced leave balances over the last three years. It was a finding in the management letter approximately 3 years ago and as a result we have actively reduced staff leave balances since then. There are only a handful of staff with high leave balances and we continue to monitor.

Committee member, Phil Ross made the following comments, observations and queries:

- Congratulated the CFIO and team on putting the accounts together and being on track.
- In the report where reference is made to movements between years, (e.g. Workers comp being up $157K), if you show the percentage change as well it provides more context for the reader. Percentage changes are there for some but not all but to get a bit more perspective on it showing the percentage change as well as the dollars does help the reader. For example, the overall receivables is up 23%, this is a bit more impacting when you read the movement from the prior year. The CFIO will update the report to be presented to Council.
- Question in relation to the internal borrowing against the internal restricted reserves. That requires a resolution of Council. Has that been done? CFIO advised it was resolved at the 26 October 2020 meeting.
- CFIO provided a separate report to Council and will distribute the report and resolution to the Committee for reference. The report addressed and mitigated the impact of lower cash flows including deferring capital works projects and adjusting some reserves and to accept the internal borrowing against reserves. CFIO is putting a report up to this month's Council meeting a plan to defer more capital works projects that were to be contracted out as the projects can be deferred with minimal impact.
- Special schedules – special schedule 7 on page 7 of 11. These aren't audited however if you look at the assets in condition as a percentage all roads are in the worst condition.
- Council's Finance Manager advised that the figures are no correct and will get them corrected. 1.5million may be correct however the percentage is not.

- The CFIO stated that Council needed to have strategies going forward to deal with the issues they are facing. There have been regular reports to Council and we continue to monitor cashflow on a daily/ weekly basis and also report to the Finance Committee each month on how we are tracking. We will have a better idea at the end of November with rates instalments due and more water notices due. We are reducing our expenditure and cash going out the best we can without impacting our services to the community. Focusing on holding back on contract capital works projects to save on cash going out and plant replacement where practical.
- CFIO provided some background on the water billing issue advising the committee that council implemented a plan to replace all of the customer's water meters with smart meters. We ran into some difficulties with that because of the topography of Lithgow there were areas where we are still having to undertake manual reads, we aren't getting the data uploaded as yet. There was a period from early July 2019 to April 2020 there were no bills going out so we had to issue catch up bills late in the last financial year. We are implementing quarterly billing now, there are still some manual reads but we are able to get nearly all of the quarter one bills out for 2020/21 Quarter One. The payment terms have been extended to give ratepayers time to pay with other notices also due.

Committee member Phil Burgett made the following comments, observations and queries:

- In relation to the revaluation of the assets of the $58 million – how did that process go? Where there any specific factors that fed into the revaluation. Sought clarity whether it was attributable to general changes in conditions or found assets we didn't know we had?
- Finance Manager advised that revaluations were done due to the timing of the asset management module being implemented. The data that we have now, especially in relation to roads, is the most accurate we have ever had. With regards to roads, this equates to $56 million of the total $258 million carrying amount. We found over 600,000sqmtrs of sealed roads which was previously classified as unsealed which the valuers have valued at $26 million, increasing the value of the road network. Bulk earth works was another asset class where we had some issues with data and that was worked out by the valuers, so there was an increase there also. In addition, there was an increase in stormwater asset values. There was a number of roads where stormwater had never been put into the asset register which was found through this process. Not a material increase in unit costs just that we have found and classified the assets properly.
- Revaluation was done by a contractor. Some of the valuation was done on site but because of COVID most was done from Brisbane. The contractor did our previous revaluation.
- The auditor didn't indicate any issues with revaluations. They are still reviewing.
- In the 2017 revaluation, assets went up 25%, they went up from $412 million to $516million as there were flaws in the 2015 valuations and also we had a $50 million prior year adjustment.
- Finance Manager is now 98% confident that the data and assets we have in our register in relation to roads is accurate. We still have asset issues in the water and waste water area which were not due for revaluation.

- This program to consolidate and develop the asset management systems for roads and bulk earth works is on track with cleaning up our data and making sure that implementation plans are on track. Water and Wastewater wasn't revalued this year. We are not due to do our revaluations for another two years, water and wastewater asset values are indexed annually.
- CFIO advised that we will be undertaking a comprehensive review of the long term financial plan and our strategies.
- COVID is not entirely responsible for our current situation Fallout from the revaluation just on the road is an increase in depreciation of $800,000 p.a. Depreciation expense is approx. $13million.
- What is the process for assessing and reviewing the asset values and condition of assets? Assets are reviewed by the managers annually and they sign off on their condition.
- Processes in place to review our assets – asset managers provide a certificate to say they have reviewed the asset. The certificate goes to the auditors and is retained for record keeping purposes. Auditor does not have any concerns with how Council is undertaking this process.
- Query was raised in relation to RFS assets and whether we record these assets?
- What has been the impact on council having to adjust to the new standards around leasing. Council didn't have many leases for the 2019/20 year. That will change with a plant hire arrangement for the waste facility Crown land minimal value leases have turned up since the 1 July 2020.
- With regards to the special purpose financial report – balance sheet for water is showing that the cash is over drawn CFIO advised that is correct and is related to debtors.

Update from Crowe

Gabriel Fanople – Auditor provided an update on where the audit was up to.

CFIO advised that Council's plan is to present the financial statements to the 23rd November meeting along with a presentation from the auditors and the deadline for reports is at the end of next week.

Gabriel indicated that they should be fine for the 23rd. Following this week they should have a clearer picture of where they are at. At this stage they couldn't see any reason for us to apply for an extension to the 30 November deadline. The completion deadline is 16 November and if it was required we would need to have something from the auditor's office to explain any delay. Additionally, we would need to call an extra ordinary Council meeting so there would be some impacts if we can't meet the deadline.

Gabrielle indicated the 23 November deadline should be fine; he just needs to liaise with Cheriee Bultitude at the Audit Office.

General Discussions

Debtors accounts are likely to increase with Council`s management of the solid waste facility. The accounts will require credit applications. Committee raised concerns with zombie companies arising and council needs to ensure processes are in place.

Management letter arising from the final audit – what is the situation in terms of timing? Gabriel advised that they are hoping to have the letter delivered to Council for the 30 November deadline. Copy of letter will be sent to the chair of the audit committee also.

Cash expense cover ratio – Finance manager advised that accounting code of practice requires term deposit for 3 months to be reported in cash but with the poor interest rates situation, to obtain the best interest rates, most term deposits are now 6 months so excluded from the ratio calculation. Every week we have an investment maturing and essentially $26 million in reserves, so $1million a week to cover our cashflow requirements whilst maximising our interest. We are making more use of our cash management account which has a higher interest rate.

Craig reiterated to the committee that the current financial situation is the highest priority for the executive team. There is a lot of effort going into making sure water accounts are all sent out on time. We have a long term financial plan but we really need to drive all of the assumptions in it and look at other revenue opportunities. High cost items are being reviewed (e.g. Fish River water access costs, worker's compensation). We need to align strategies with our Long Term financial plan. We are also looking at our longer term strategies on how we deliver our services.

The Committee received the statements subject to completion of the Audit Office review.

CFIO will send out final statements with minor changes and confirmation of when we lodge.

RECOMMENDATION

> **THAT** the committee receive and note the draft financial statements and confirm discussions around the issues considered.

MOVED – Phil Burgett **SECONDED –** Neil Maltby

There being no further business the meeting concluded at 11.11a.m.