

C20/6187 – LATE ITEM FROM FINANCIAL MANAGEMENT, AUDIT, RISK AND COMPLIANCE COMMITTEE - CITY OF MELVILLE ANNUAL FINANCIAL REPORT FOR 2019-2020 (REC) (CONFIDENTIAL ATTACHMENT)

Ward : All
 Category : Operational
 Subject Index : Financial Reporting – Annual Financial Reports
 Customer Index : Deloitte Touche Tohmatsu under the supervision of the Office of the Auditor General (OAG)
 Disclosure of any Interest : No Officer involved in the preparation of this report has a declarable interest in this matter.
 Previous Items : Item C19/6171 City of Melville Annual Financial Report for 2018-2019 – 10 December 2019 Ordinary Meeting of Council
 Works Programme : Not Applicable
 Funding : Not Applicable
 Responsible Officer : Alan Ferris
 Director Corporate Services

AUTHORITY / DISCRETION

DEFINITION

<input type="checkbox"/>	Advocacy	<i>When the Council advocates on its own behalf or on behalf of its community to another level of government/body/agency.</i>
<input type="checkbox"/>	Executive	<i>The substantial direction setting and oversight role of the Council. e.g. adopting plans and reports, accepting tenders, directing operations, setting and amending budgets.</i>
<input type="checkbox"/>	Legislative	<i>Includes adopting local laws, town planning schemes & policies.</i>
<input type="checkbox"/>	Review	<i>When the Council operates as a review authority on decisions made by Officers for appeal purposes.</i>
<input type="checkbox"/>	Quasi-Judicial	<i>When the Council determines an application/matter that directly affects a person's right and interests. The judicial character arises from the obligation to abide by the principles of natural justice. Examples of Quasi-Judicial authority include town planning applications, building licences, applications for other permits/licences (eg under Health Act, Dog Act or Local Laws) and other decisions that may be appealable to the State Administrative Tribunal.</i>
<input checked="" type="checkbox"/>	Information	<i>For the Council/Committee to note.</i>

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- All Local Government Financial statement audits are conducted by the Office of the Auditor General (OAG). For the City of Melville the OAG appointed Deloitte Touche Tohmatsu (Deloitte) to conduct the audit work, with the OAG being responsible for issuing the audit opinion.
- This report presents the 2019-2020 Annual Financial Report, the Audit Findings Report and a summary of variances. These were presented to the Financial Management Audit, Risk and Compliance Committee on 23 November 2020.
- The FMARCC noted the Annual Financial Report and the Office of the Auditor General's Audit Finding Report and resolved to recommend that Council accept the Community Annual Report 2019-2020, including Parts A and B (Annual Financial Report) at the 8 December Council Meeting.
- The overall closing funds/unrestricted cash amount available to be carried forward to 2020-2021 is \$1.99m. The 2020-2021 Annual Budget assumed that no funds would be carried forward.
- In accordance with Council resolution (Special Meeting of Council held 29 June 2020 Item C20/6177– Consideration and Adoption of the 2020-2021 Budget), the surplus funds will be transferred to the Rates Equalisation Reserve account.

BACKGROUND

The *Local Government Act 1995* (the Act) prescribes the following (but not limited to) in relation to the Annual Report:

- Section 5.53(1) requires a local government to prepare an Annual Report for each financial year.
- Section 5.53(2)(f) states that the Annual Report must contain the financial report for the financial year.
- Section 5.54 requires the Annual Report for a financial year is to be accepted by the local government no later than 31 December after that financial year.
- Section 5.27 of the Act specifies that a General Meeting of the Electors is to be held on a day selected by the local government but not more than 56 days after the local government accepts the annual report for the previous financial year.

The City refers to its Annual Report as the Community Annual Report and presents it in two parts:

- Part A – contains the full-text summary and an extract of the Annual Financial Report
- Part B – contains the full Annual Financial Report and a copy of the letter from the Office of the Auditor General.

The Community Annual Report Parts A and B for 2019-2020 requires acceptance by the Council by 31 December. This report is the vehicle whereby the Council will adopt the full Annual Financial Report for 2019-2020 after consideration by the Financial Management, Audit, Risk and Compliance Committee (FMARCC).

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This item presents the City of Melville's Annual Financial Report for 2019-2020 and supporting analysis in the following attachments:

1. Variances Report on Rate Setting Statement [6187A Variances Report](#)
2. Office of the Auditor General's Audit Findings Report 6187B (Confidential Attachment)
3. Audited Annual Financial Report (including):
[6187 Annual Financial Report 2019-2020](#)
 - a. Statement by the Chief Executive Officer
 - b. Management Representation Letter
 - c. Statements of Comprehensive Income by Nature or Type
 - d. Statements of Comprehensive Income by Program
 - e. Statement of Financial Position
 - f. Statement of Changes in Equity
 - g. Statement of Cash Flows
 - h. Rate Setting Statement by Program
 - i. Notes to and Forming Part of the Annual Financial Report.

The 2019-2020 Annual Financial Report shows a positive result for the 2019-2020 financial year for the City, with an overall cash surplus of \$1.99m. In accordance with previous Council resolutions, the surplus is transferred to the Rates Equalisation Reserve to be used to minimise the need to raise rates in future years or to meet any budget shortfalls identified during budget reviews. A brief analysis of the significant variances which contributed to this positive position is included in the Financial Implications section of this report and in the Variance Report on Rate Setting Statement Attachment [6187A Variances Report](#).

The financial outcomes for the year are specified in the Annual Financial Report and are summarised in the Financial Implications section of this report.

The City will receive an unqualified audit opinion in respect to the 2019-2020 Annual Financial Report. There are nine findings and recommendations identified during the Audit, with one finding being rated significant and eight moderate. The City has provided management comments and timelines in response to the recommendations.

The findings, recommendations and management responses are attachment 6187B were distributed to Elected Members on Friday 27 November 2020 under confidential cover.

The Annual Financial Report and Audit were impacted by late changes to The *Local Government (Financial Management) Regulations 1996* (the Regulations). Amendments to the Regulations were gazetted on 6 November 2020 and this resulted in considerable adjustments to the financial statements and required subsequent review by the auditors. The Annual Financial Report complies with the amended Regulations.

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No external public consultation has been carried out.

II. OTHER AGENCIES / CONSULTANTS

Amendments to the *Local Government Act 1995* were passed by State Parliament that enabled the Auditor General to audit Local Government. The 2019-2020 financial year is the City's second audit under the OAG with Deloitte undertaking the work, on behalf of the OAG.

The OAG and Deloitte reported to the 23 November FMARCC meeting to discuss the Audit Completion Report including the Audit Findings. The OAG will issue the final Auditor's opinion on the financial statements for 2019-2020 to the Mayor, the CEO, and the Minister for Local Government and a copy is included in the Annual Financial Report.

STATUTORY AND LEGAL IMPLICATIONS

Section 5.53 of the Act headed "Annual reports" specifies that:-

"(1) The local government is to prepare an annual report for each financial year and that.

(2) The annual report is to contain... (f) the financial report for the financial year; ..."

Section 5.54 of the Act headed "Acceptance of annual reports" specifies that the Annual Report for the financial year is to be accepted by the Local Government no later than 31 December after that financial year.

Section 5.27 of the Act specifies that a General Meeting of Electors is to be held within fifty-six (56) days after the local government accepts the Annual Report for the previous financial year.

Section 5.94 of the Act provides that *"a person can attend the office of a local government during office hours and, unless it would be contrary to section 5.95, inspect, free of charge, in the form or medium in which it is held by the local government and whether or not it is current at the time of inspection — ... (c) any annual report;"*

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Section 6.4 of the Act headed “Financial report” specifies that:-

- “(1) A local government is to prepare an annual financial report for the preceding financial year and such other financial reports as are prescribed.*
- (2) The financial report is to —*
- (a) be prepared and presented in the manner and form prescribed; and*
 - (b) contain the prescribed information.*
- (3) By 30 September following each financial year or such extended time as the Minister allows, a local government is to submit to its auditor —*
- (a) the accounts of the local government, balanced up to the last day of the preceding financial year; and*
 - (b) the annual financial report of the local government for the preceding financial year.”*

The Annual Financial Report has been prepared in accordance with all relevant legal requirements and accounting standards.

FINANCIAL IMPLICATIONS**Operating Surplus**

The net result for the 2019- 2020 financial year was a net result of \$9.58m as calculated in the Statement of Comprehensive Income.

The operating surplus is the result of:

- Operating revenue of \$123.9m
- Operating expenditure of \$115.4m
- Non-operating revenue of \$2.405m
- The City’s share of the net result of the joint venture with the Southern Metropolitan Regional Council (SMRC) of \$0.057m profit.
- The City’s share of the net loss of Carawatha Redevelopment of \$0.14m
- Loss on asset disposals of \$1.208m

The operating surplus measures the ability of the City to cover its operational costs and have revenues available for capital funding. The cash surplus is then calculated following the inclusion of the capital outlays and reserve transfers.

The Department of Local Government and Communities (DLGC) set an advanced target for the Operating Surplus Ratio of greater than 0.15 (the higher the better). The City achieved a ratio of 0.06, which has declined from 0.09, due to minimal rate increases and increases in employee related expenditure.

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Cash Surplus

The cash surplus for the 2019-2020 financial year was \$1.99m as calculated in the Rate Setting Statement.

This is determined by the inclusion of the following items:

- Operating revenue
- Operating expenditure
- Non-operating revenue
- Capital expenditure
- Reserve account transfers
- Reversal of non-cash items (such as asset depreciation)

This surplus was carefully analysed to fully understand the drivers behind this variance. There are a number of variances that are offset by a corresponding value such as income, expenditure or a transfer to or from reserve. In these cases, the variance does not contribute to the overall surplus and therefore these not been reflected in the summary below. The key areas contributing to the \$1.99m surplus were:

	Variance
General Purpose Funding positive variance	\$1,152,346
Operating Income negative variance	(\$1,375,433)
Operating Expenditure positive variance	\$2,433,251
Capital Income negative variance	(\$32,861)
Capital Expenditure positive variance	\$27,224
Net Reserve transfers negative variance	(\$204,574)
Other negative variances	(\$5,298)
Total Surplus	\$1,994,655

Local Government (Financial Management) Regulations 1996

The *Local Government (Financial Management) Regulations 1996* (the Regulations) were recently amended (6th November 2020) and require plant and equipment assets to be measured under the cost model, rather than at fair value. Other assets such as land, buildings, infrastructure and investment property must be carried at fair value and revalued on a five year cycle (rather than three yearly), unless the fair value is materially different from the carrying amount. The City has already undertaken the valuation exercise in previous years and new changes will have an impact in future years.

The City has also removed \$6.25m of vested land values, such as those associated with golf courses. The changes have been appropriately disclosed in the notes to the financial statements in 2019-2020 in accordance with the amended regulations.

Provision for remediation of the John Connell Reserve

The City has a former landfill site, John Connell Reserve, which is classified as a contaminated site requiring remediation. As a result, the City is required to recognise the required remediation as a liability in the financial statements.

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An independent consultant provided indicative costs of the scope of works to satisfy the Department of Water and Environmental Regulation requirements for rehabilitation and remediation costs to the John Connell Reserve Landfill site.

The indicative costs provided of \$4.213m have been recognised as a prior year adjustment in the financial statements. This is the estimate of the present value of the expenditure required to settle the obligation at the reporting date. These remediation costs will be reviewed annually and any changes in the estimate will be reflected in the present value of the remediation provision at each reporting date in future.

Period year adjustments

The City made the following prior period adjustments during the year in order to comply with the requirement of Accounting Standards, the *Local Government Act 1995* and the City's accounting policies.

1. Recognition of a provision in relation to rehabilitation and remediation costs of \$4.213m for the John Connell Reserve, former landfill site.
2. Recognition of site improvements amounting \$4.55m and associated depreciation of \$0.437m for certain vested Crown reserve sites. These improvements had not previously been recognised in the City's financial statements.
3. Reclassification of site improvement assets amounting to \$2.275m previously recognised as vested land rather than site improvements. Associated depreciation of \$0.091m for the 2018-2019 year was also accounted as a prior year adjustment.

The changes have been appropriately disclosed in the notes to the financial statements in 2019-2020.

Recognition of joint venture in Carawatha Redevelopment Project

The City has recognised the joint venture agreement for the Carawatha redevelopment project 'The Gallery' between Satterley Group and City of Melville and accounted for this using the equity method in the 2019-2020 financial statements. The City's equity share is 50% and the City's interest in the assets, liabilities, revenue and expenses of joint operations are included in the respective line items of the financial statements.

Reserves

The City's cash-backed reserves total \$169m as at 30 June 2020, which is an increase of \$10.72m from the previous financial year. The City uses a number of reserves to streamline funding needs and quarantine funds for specific purposes.

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The increasing reserve balance is due mainly to the net result of the following:

Reserve	Increase / (Decrease) \$	Comment
Commercial Refuse Reserve	358k	\$284k transfer to reserve for surplus generated from commercial waste operations. \$11k transfer from reserve for purchase of commercial refuse bins.
Community Facilities Reserve	(512k)	\$3.27m transfer to reserve (as per asset management plans) compared with a higher transfer from reserve of \$4.28m to fund actual spend on community facilities.
Community Surveillance and Security Reserve	113k	\$109k over recovery of operating expenses transferred to the reserve.
Fleet Services Vehicles, Plant and Equipment Replacement Reserve	1.27m	\$2m transfer to reserve (as per asset management plan) compared with a lower transfer from reserve of \$953k. Funds are required in future years to ensure optimal life cycle replacement of assets.
Future Works Reserve	8.24m	\$10.85m (as per asset management plans) and \$1m from rates growth transferred to reserve compared with a lower transfer from reserve of \$4m. Funds are required for identified projects in future years.
Infrastructure Asset Management Reserve	5.52m	\$12.66m (as per asset management plans) and \$1.14m (Federal Assistance Grant funds for roads) transferred to reserve compared with a lower transfer from reserve of \$9m. Funds are required for identified projects in future years.
Land and Property Reserve	3.40m	\$2.15m (Federal Assistance Grants-General) transferred to reserve and \$807k interest earned compared with a lower transfer from reserve of \$333k. Funds are required for identified projects in future years and to fund strategic property and land services.
Libraries, Museums and Arts Equipment and Specialised Fitout Reserve	77k	\$101k transferred to reserves (as per asset management plans) compared with a lower transfer from reserves of \$27k.
Melville North UGP & Streetscape Enhancement Reserve	(1.72m)	\$1.74m transferred from reserves to fund Western Power cash calls.
Organisational Environment Sustainability Initiative Reserve	(242k)	\$250k transfer to reserve (as per budget) compared to \$518k transfer from reserve to fund environment sustainability projects. Funds are required for identified projects in future years.
Parking Facilities Reserve	74k	\$65k transfer to reserve (as per asset management plans).
Private Swimming Pool Inspection Fee Reserve	90k	\$86k over recovery of operating expenditure transferred to reserve.
Public Open Space and Urban Forest Reserve	806k	1% of rates is transferred to this reserve annually. This amount was \$887k and higher than the transfer from reserve to fund projects. Funds are required for identified projects in future years.

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Reserve	Increase /(Decrease) \$	Comment
Rates Equalisation Reserve	(6.16m)	The adjusted unallocated surplus of \$1.91m from the 2018-2019 annual accounts, \$1.415m relating to Cash Calls for Alfred Cove East underground power project being returned to this reserve and \$734k identified as surplus at the Mid Year Review of 2019-2020 are significant items that make up the transfer to reserve. Transfers from the reserve relate to \$7.98m transferred to Future Works and Infrastructure Asset Management Reserves for change room upgrades and river walls and \$2.23m in relation to higher waste disposal costs.
Recreation Centres Specialised Plant, Equipment and Structures Reserve	87k	\$435k transfer to reserve (as per budget) compared with a lower transfer from reserve of \$385k. Funds are required for identified projects in future years, including pool repairs.
Refuse Bins Reserve	(576k)	\$384k transfer to reserve (as per budget) compared with a higher transfer from reserve of \$920k in relation to FOGO bin contract costs.
Risk Management and Insurance Equalisation Reserve	589k	Funds transferred to reserve consist of \$361k refunds from the Local Government Insurance Scheme and \$100k as funds set aside for risk management. Funds required for insurance related contingencies in the future.
Special Projects Reserve	(299k)	Annual funds transfer to the reserve of \$700k (as per budget) compared against higher transfer from reserve for strategic urban planning project costs.
Various Reserves	(395k)	
	\$10.72m	

Financial Ratios

Financial ratios are designed to provide users of annual financial reports with a clearer interpretation of the performance and financial results of the City.

The overall financial performance for the City as reported in the Annual Financial Report and the accompanying notes are positive. While the City has maintained a healthy Financial Health indicator (FHI) since 2014-2015 of 98 or above, the current score dropped to 85 for 2019-2020. The decrease is due to the operating surplus ratio that is performing slightly below as a result of minimal rate increases and higher material and contracts costs during the year. The DLGSC consider an overall FHI result of 70 or higher indicates sound financial health.

The table below outlines the seven financial ratios for 2019-2020, with comparisons to 2018-2019. All of the City's financial ratios, except for the Asset Consumption and Operating Surplus ratios, continue to perform above the recommended benchmarks set by the Department of Local Government and Communities (DLGC).

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Ratio (higher the better)		DLGC Target	2019-2020	2018-2019	Comments
Liquidity Ratio					
Current Ratio	Ability to meet short-term financial obligations out of unrestricted current assets	> 1	1.10	1.30	Indicates good short-term financial strength but slightly dropped due to an increase of sundry creditors in current liabilities.
Debt Ratio					
Debt Service Cover Ratio	Ability to produce enough cash to cover debt payments	> 5	65.61	66.96	Indicates a strong ability to produce enough cash to cover its debt payments.
Coverage Ratio					
Own Source Revenue Coverage Ratio	Ability to cover costs through own taxing and revenue	> 0.90	1.02	1.05	The ratio has declined due to minimal rate increases and a significant increase in depreciation cost
Financial Performance Ratio					
Operating Surplus Ratio	Ability to cover operational costs and have revenues available for capital funding or other purposes	> 0.15	0.06	0.09	The ratio has declined due to minimal rate increases and a significant increase in depreciation cost
Asset Ratios					
Asset Sustainability Ratio	The extent to which assets are being replaced as they reach the end of their useful lives	between 0.90 and 1.10	1.00	1.26	The ratio has declined due to higher Depreciation cost and a delay in capital work projects.
Asset Consumption Ratio	The extent to which depreciable assets have been consumed	between 0.60 and 0.75	0.51	0.52	The ratio is slightly below the recommended range due to the condition of the asset.
Asset Renewal Funding Ratio	Ability to fund projected asset renewals /replacements in the future	between 0.95 and 1.05	1.00	1.00	The ratio has remained the same.

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There are no strategic, risks or environmental management implications associated with this report.

AMENDMENT TO LOCAL GOVERNMENT (FINANCIAL MANAGEMENT) REGULATIONS 1996

The recent amendment to the *Local Government (Financial Management) Regulation 16* on 6th November 2020 requires the City to account for the removal of the vested land values, such as those associated with golf courses, etc. Prior to the amendment, the Regulation had permitted the inclusion of land under control or management including land associated with golf courses, showgrounds, racecourses or any other sporting or recreational facility of State, or of regional, significance.

POLICY IMPLICATIONS

CP - 025 Accounting Policy – defines the policy relating to the preparation of the Annual Financial Report. It should be noted that the Council Policy defines some of the accounting policies that are applied to the preparation of the annual financial report and other requirements are set and described in the Accounting Standards.

ALTERNATE OPTIONS AND THEIR IMPLICATIONS

Should the Annual Report (which includes the Annual Financial Report) not be adopted by the Council, this would delay the annual general meeting of electors until such time as it is adopted.

CONCLUSION

The 2019-2020 Annual Financial Report has been completed and an unaudited extract will be included in the Community Annual Report for 2019-2020 (Part A), with the full audited Annual Financial Report (Part B) will be available on the City's website, at its five libraries, the Civic Centre and in printed form to individuals upon request.

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COMMITTEE RECOMMENDATION

That the Council:

- 1 notes the Office of the Auditor General's Audit Findings Report (confidential) and**
- 2 notes the City of Melville 2019-2020 Annual Financial Report.**

Footnote:

- 1 When the Council accepts the Annual Community Report and the Auditor's Unqualified Audit Report as attached to this report, an extract of the Annual Financial Report will be included in the Community Annual Report Part A. Part B of the Community Annual Report will contain the full Annual Financial Report and Audit Letter.