

#### 14.4 Response to 2019/20 Independent Auditor's Report

Responsible Officer	Michael Kent, Project Director Strategic Finance (CFO)
Voting Requirement	Simple Majority
Attachments	Attachment 14.4A - Independent Auditor's Report 30 June 2020

#### Purpose

To present matters identified as significant within the 2019/20 Independent auditor's report, together with actions taken or intended to be taken by Management for Council's review and acceptance.

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#### Recommendation

That Council RECEIVES the report on the adverse trend in the Asset Sustainability Ratio over the past three years and notes the actions to be taken to improve the ratio.

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## Background

1. Under the *Local Government Act 1995* (Act), Local Governments are required to prepare an Annual Financial Report each financial year and that report is to be the subject of an independent audit. The City's 2019-20 audit was conducted by the Office of the Auditor General and their report, received on 10 December 2020, is attached.
2. The 2019/20 Independent Auditor's Report identified a significant adverse trend in the in the Asset Sustainability Ratio which has been below the Department of Local Government, Sport and Cultural Industries' basic standard of 0.9 for the last three financial years.
3. Section 7.12A of the Act requires the Local Government to do the following relating to significant matters raised in the audit report:
  - 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.*
  - c. *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.*
4. This report will also be presented to Audit and Risk Committee scheduled to be held on the 22 February 2021. Any recommendations or changes requested by the Committee will be incorporated within the report to Ordinary Council Meeting scheduled to be held on the 23 February 2021.
5. Asset Sustainability Ratio
  - a. This ratio is an approximation of the extent to which assets managed by a local government are being replaced as these reach the end of their useful lives. It is calculated by measuring capital expenditure on renewal or replacement of assets, relative to depreciation expense.
  - b. Asset sustainability ratio as reported within the City's 2019-2020 annual financial report:

Department's standard	basic	2020	2019	2018
0.9		0.48	0.55	0.72

- c. The asset sustainability ratio as listed above indicates the City is deferring the renewal of existing assets.
- d. The impact of prolonged deferment of capital renewal expenditure leads to additional asset maintenance cost and significant increase in asset replacements costs in the future.

- e. This in turn creates an adverse impact within the Asset consumption ratio, which highlights the extent to which depreciable assets have been consumed by comparing their written down value to their replacement cost, and the magnitude of capital expenditure required in future to preserve their service potential.
- f. Given the ratio is calculated based on actual renewal expenditure within a financial year, the asset sustainability ratio can only be improved if the budgeted capital renewal projects are completed within the financial year.

6. Actions Taken or intended to be taken

Actions taken

- a. In late 2019 a report on Asset Management and Financial sustainability was presented by the General Manager Corporate Services to the Executive leadership team and Commissioners. The report highlighted gaps within asset renewals and its impact on the City’s long term financial sustainability. The report also identified two key recommendations to minimise the identified gaps:
  - i. For Council – to identify the importance of allocating a significant amount of funding each year for asset renewals within the budget.
  - ii. Administration – to ensure renewal projects that are funded within an annual budget are delivered within the financial year.
- b. The concerns addressed within this report was addressed by Council’s adoption of the Long Term Financial Plan which allows for significant improvements towards attaining the Department’s basic standard of the asset sustainability ratio.

The following table provides a snapshot of the asset sustainability ratio as forecasted within the Long Term Financial Plan:

**Table 7 - Projected Asset Sustainability Ratio**

20/21	21/22	22/23	23/24	24/25	25/26	26/27	27/28	28/29	29/30
●	●	●	●	●	●	●	●	●	●
79.5%	93.6%	83.0%	86.9%	87.6%	89.8%	86.1%	93.7%	91.9%	89.6%

- c. The 2021 annual budget also allows for sufficient budget funds for renewal expenditure to improve the standard of the asset sustainability ratio.

Actions to be taken

- a. The progress of budgeted capital projects will be monitored through a project management framework and reported to the Executive leadership team and Council on a regular basis. Completion of the budgeted renewal capital projects will be the key driver in improving the asset sustainability ratio.

- b. Management has also prepared a Strategic financial planning and budgeting Policy (presented to the Policy Committee held on 8 February 2021) which sets clear principles and guidelines on budget funding priorities for capital initiatives. The policy identifies the importance of funding capital renewal projects and provides guidance on minimum funding limits for total capital renewals. This policy will provide the necessary strategic direction to improve financial sustainability going forward.

## Discussion

- 7. The actions listed above addresses the significant matter identified within the 2019-2020 Independent Auditor’s Report and ensures City’s commitment towards minimising the asset renewal gap.
- 8. It is to be noted that this report is also being presented to the Audit and Risk Committee at its 22 February meeting for its consideration. Should there be any additional feedback or recommendations from that Committee relating to the report, those will be detailed via an addendum to the agenda.
- 9. Following both the consideration of Council and the Audit and Risk Committee, a copy of this report will be forwarded to the Minister.

## Stakeholder Engagement

- 10. In determining the actions to be taken the Executive leadership team and all service areas that deliver capital projects were consulted and informed.

## Decision Implications

- 11. If accepted, the City will work towards achieving the asset sustainability ratio as recommended by the Department of Local Government, Sport and Cultural Industries.

## Strategic, Legal and Policy Implications

Strategic	
<b>Strategic Community Plan Aspiration:</b>	Performance A city led by a Council and supported by an administration that is committed to sound strategy and governance, excellence in customer service and effective and sincere engagement with all stakeholders.
<b>Strategic Community Plan Objective:</b>	5.5 A financial business model underpinned by a culture of cost management, best value and strategic financial analysis that is subject to ongoing oversight, transparency and accountability
<b>Issue Specific Strategies and Plans:</b>	Statutory Compliance

Legal and Policy	
Legislation:	<a href="#"><u>Section 7.12A (4) of the Local Government Act 1995</u></a>
Legal advice:	Not Applicable
Policy	Not Applicable

## Financial Implications

There are no immediate financial implications relating to the recommendation within this report, however to improve the current adverse trend within the asset sustainability ratio, the City will require ongoing financial commitments towards funding, and more importantly to delivering asset renewal programs.

## Relevant Documents

Not Applicable.

## Further Information

Not Applicable.

## Council Resolution (OCM-21/02-018)

**Mover** Lord Mayor Zempilas  
**Seconder** Deputy Lord Mayor Anghie

That Council RECEIVES the report on the adverse trend in the Asset Sustainability Ratio over the past three years and notes the actions to be taken to improve the ratio.

**CARRIED EN BLOC (9/0)**

**For** Lord Mayor Zempilas, Deputy Lord Mayor Anghie, Crs Bain, Bevan, Fleeton, Gobbert, Gordon, Ko and Lezer  
**Against** None

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## Auditor General

### INDEPENDENT AUDITOR'S REPORT

To the Councillors of the City of Perth

#### Report on the Audit of the Financial Report

##### **Opinion**

I have audited the annual financial report of the City of Perth which comprises the Statement of Financial Position as at 30 June 2020, and 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, as well as 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 Perth:

- (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 2020 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 Notes 1 and 11 to the annual financial report, which describe the basis of accounting. The annual financial report has been prepared for the purpose of fulfilling the City's financial reporting responsibilities under the Act, including the Local Government (Financial Management) Regulations 1996 (Regulations). My opinion is not modified in respect of these matters:

- (i) Regulation 17A requires a local government to measure vested improvements at fair value and the associated vested land at zero cost. This is a departure from AASB 16 *Leases* which would have required the entity to measure the vested improvements also at zero cost.
- (ii) In respect of the comparatives for the previous year ended 30 June 2019, Regulation 16 did not allow a local government to recognise some categories of land, including land under roads, as assets in the annual financial report.

##### **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 the 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.

A further description of my responsibilities for the audit of the annual financial report is located on the Auditing and Assurance Standards Board website at [https://www.auasb.gov.au/auditors\\_responsibilities/ar4.pdf](https://www.auasb.gov.au/auditors_responsibilities/ar4.pdf). This includes the identification and assessment of the risk of material misstatement due to fraud arising from management override of controls. This description forms part of my auditor's report.

### **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 matter indicates a significant adverse trend in the financial position of the City:
  - a. The Asset Sustainability Ratio as reported in Note 35 of the annual financial report has been below the Department of Local Government, Sport and Cultural Industries' basic standard of 0.9 for the last three financial years.
- (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.

### **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 Perth for the year ended 30 June 2020 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  
10 December 2020