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Local Government: 2014–15 Audit Snapshot

Tabled 25 November 2015

The Auditor-General provides assurance to Parliament on the accountability and performance of the Victorian Public Sector. The Auditor-General conducts financial audits and performance audits, and reports on the results of these audits to Parliament.

On 25 November 2015, the Auditor-General tabled his performance audit report, *Local Government: 2014–15 Audit Snapshot*.

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Overview

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Report presents outcomes and observations from the 2014–15 financial report and performance statement audits of 79 Victorian local councils.

Key messages:

- Net surplus of more than $900 million annually in the past five years.
- Local councils generally received a low financial sustainability risk assessment.
- Impact of the re-phasing of Commonwealth financial assistance grants.
- Local councils continue to face challenges to spend at sufficient levels on capital works and asset maintenance.

This report covers the results of the 2014–15 financial audits for the local government sector—consisting of 79 local councils, 11 regional library corporations and 13 associated entities.

All local councils received clear audit opinions on their financial statements.

The local government sector generated a net surplus of greater than $900 million in the past five years, and has low financial sustainability risks. However, the 2014–15 result has been partly driven by the advance payment of $270 million of Commonwealth grants in that year.

Notwithstanding, some local councils continue to face the ongoing challenge of maintaining spending on capital works and existing assets, at sufficient levels.

This strong position may be impacted by the introduction of rate-capping in 2016–17. Legislation to introduce rate capping is currently before Parliament.

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Background

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Key balances at 30 June 2015

Cohort	Revenue ($ million)	Expenditure ($ million)	Net result ($ million)	Net assets ($ million)
Metropolitan	3 856.3	3 377.8	478.5	40 251.9
Interface	2 148.5	1 593.5	555.0	16 011.0
Regional city	1 415.5	1 188.7	226.8	9 651.5
Large shire	1 237.5	1 074.4	163.1	9 438.7
Small shire	522.2	455.0	67.2	4 030.4
Total	**9 180.0**	**7 689.4**	**1 490.6**	**79 383.5**

The sector had a net surplus of $1.5 billion in 2014–15 ($923.6 million in 2013–14)

Key balances of the 79 local councils have been split into five cohorts based on size, demographics and funding. These cohorts are consistent with the classification used by Local Government Victoria.

The sector had a net surplus of $1.5 billion (in 2013–14 the surplus was $923.5 million). The higher surplus in 2014–15 was partly attributed to the Commonwealth's payment of approximately $270 million, (50 per cent) of the 2015–16 financial assistance grants in the current year.

Local councils have effectively received 18 months of financial assistance grants of $811.5 million, compared to six months of grants in 2013–14 of $265.9 million.

The Interface cohort generated the largest net surplus for the financial year, with a surplus of $555 million ($355 million in 2013–14). Interface councils are the 10 councils that form a ring around metropolitan Melbourne.

Interface local councils have a larger proportion of grant revenue and development contributions for local infrastructure, compared to the other four cohorts as there is greater community and infrastructure development in these areas to service the growing populations.

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Financial sustainability risk indicators

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Indicator	Industry average		Metro average 2014–15	Interface average 2014–15	Regional average 2014–15	Large shire average 2014–15	Small shire average 2014–15
	2010–11 to 2014–15	2014–15					
Net result ratio	12.68%	15.42%	12.14%	24.33%	15.44%	12.59%	12.62%
Liquidity ratio	2.17	2.29	1.99	2.49	1.87	2.36	2.76
Internal financing ratio	117.98%	148.75%	169.46%	155.14%	122.45%	155.14%	150.00%
Indebtedness ratio	25.23	26.70	16.34	32.86	32.45	32.74	19.12
Capital replacement ratio	1.61	1.54	1.50	1.86	1.69	1.26	1.38
Renewal gap ratio	1.10	1.05	1.14	1.06	0.98	1.01	1.04

Six financial sustainability risk indicators were assessed across each of the 79 local councils. The indicator results are calculated using the financial transactions and balances included in each council's audited financial report.

As a whole, the local government sector has a low financial sustainability risk partly due to the early payments of the Commonwealth financial assistance grant, which was referred to earlier. As a result:

- only two local councils reported a net deficit in 2014–15.
- liquidity ratio in 2014–15 has improved from already good levels.

Metro, large and small shire local councils have a medium-risk rating for their capital replacement ratio, and are at risk of not spending enough on capital assets to service the rate of use.

Regional city local councils continue to be at risk of not spending enough on asset renewal.

This report does not include individual financial sustainability results for local councils. We are reviewing whether to reintroduce the individual financial sustainability results in future snapshot reports.

General internal controls

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- Internal controls at local councils were adequate for maintaining the reliability of financial reporting.
- However, 51% of our previous year's audit findings relating to high- and medium-risk internal control deficiencies are yet to be rectified.
- Key areas that need improvement:
  - Supplier payments and payroll
  - IT controls
- We will follow up the status of these deficiencies.

Internal controls at councils were adequate for maintaining the reliability of financial reporting. Nevertheless, we identified a number of instances where important internal controls need to be strengthened. These matters were reported to the local councils and their management teams and included 103 high-risk and medium-risk rated matters in 2014–15 (there were 99 matters in 2013–14).

Our review of prior period issues identified 51 per cent of high- and medium-risk internal control deficiencies that are yet to be rectified. That these control deficiencies should remain unremedied is a poor reflection on both the management and governance of these councils. Local councils need to accelerate the rate at which they are resolving our audit findings.

We will continue to follow up the status of all outstanding issues with local councils.

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Performance reporting

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- New performance reporting regime—Local Government Performance Reporting Framework—from 1 July 2014.
- Unqualified audit opinions issued in 2014–15.
- No established performance targets.
- Further refinement required on local councils performance reporting processes.

The 2014–15 reporting period was the first year local councils were required to prepare information on a prescribed set of performance indicators, in accordance with the Local Government Performance Reporting Framework. The new regime requires extensive financial and non-financial information to be disclosed.

Parliament can have confidence in the fair presentation of the performance statements of all 79 local councils as they all received clear audit opinions for 2014–15.

Wodonga City Council received a clear audit opinion containing an emphasis of matter paragraph to highlight that the council had not obtained results for two performance indicators.

It is a significant deficiency of the new performance reporting framework that targets are not included in performance statements for performance indicators. Local councils should establish targets so that they can better interpret their results and make meaningful conclusions about their performance.

The performance reporting methods were generally adequate, however, local councils need to refine their processes around performance data preparation and improve their processes on quality assurance.

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Development contributions

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- Controls over development contributions by local councils are generally sound.
- However, improvements can be made which include:
  - acquitting each development contribution plan by reporting publicly
  - actively assessing and managing risks in their risk register
  - preparing cash flow forecasts to better manage financial impacts
  - conducting an internal audit review on a periodic basis.

The sector received development contributions of approximately $815 million in 2014–15—this included cash contributions and non monetary contributions. In 2013–14, approximately $696 million was received in development contributions.

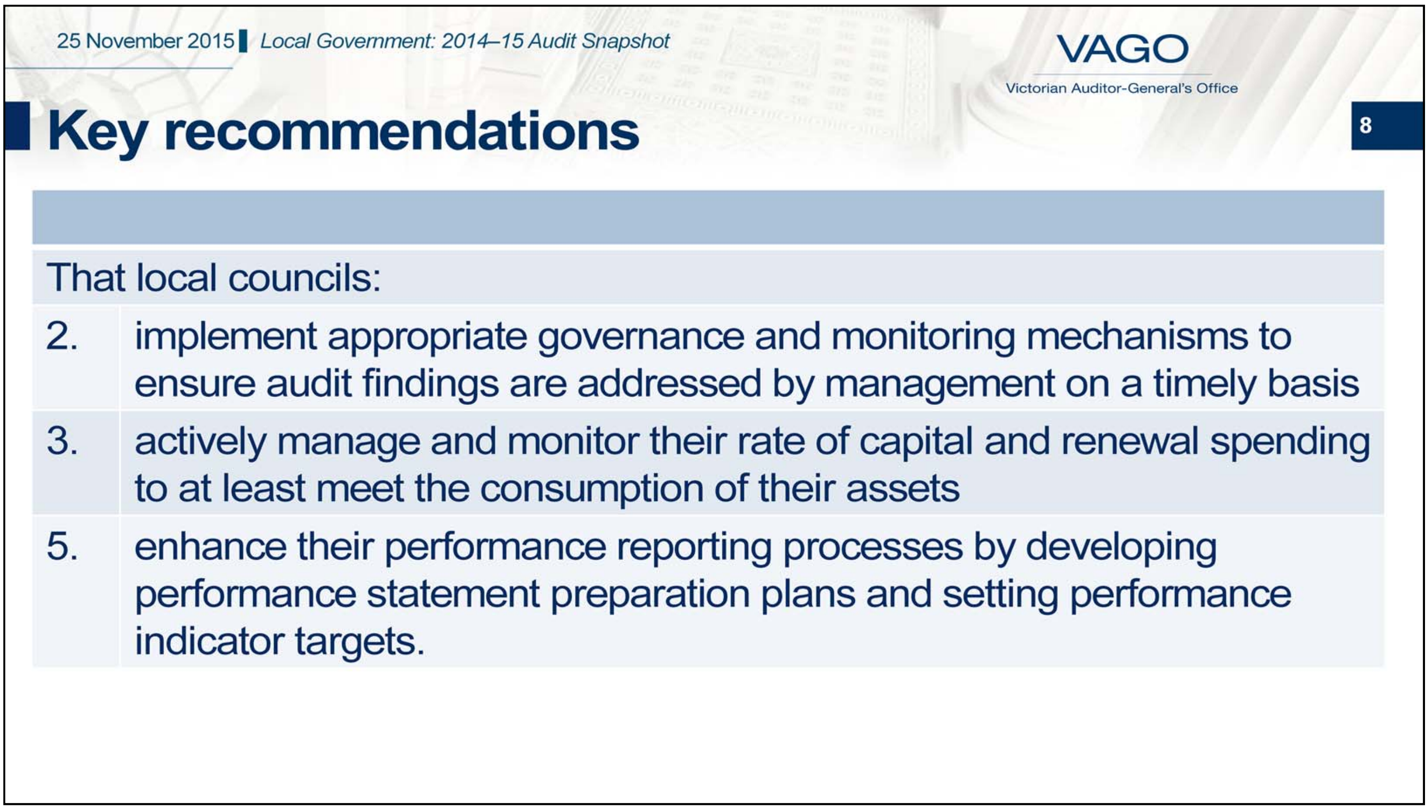
Due to the large value of development contributions and those contributions often being once-off for specific developments, local councils need to have an effective framework in place. There are no existing legislative or other requirements that specify the elements of an effective framework, on how local councils should manage these development contributions.

We surveyed all 79 local councils and reviewed three 'case-study' local councils against key elements of an effective development contributions management framework, and identified areas for improvement.

Our review of the 59 local councils receiving development contributions greater than $1 million identified:

- 22 councils did not provide an acquittal report to senior management and/or councillors, on the spending of development contributions.
- 40 councils did not formally manage risks arising from development contributions; and
- 52 councils have not conducted an internal audit review of the management of development contributions in the past three years.

Local councils generally had some elements of an effective development contribution management framework in place. However, improvements can be made to strengthen the framework around risk identification and management, monitoring and reporting.



A total of 10 recommendations were made.

The five key recommendations are that local councils:

- implement appropriate governance and monitoring mechanisms to ensure audit findings are addressed by management on a timely basis
- actively manage and monitor their rate of capital and renewal spending to at least meet the consumption of their assets
- enhance their performance reporting processes by developing performance statement preparation plans and setting performance indicator targets.

Key recommendations – *continued*

That local councils:	
8.	include risks associated with development contributions and infrastructure asset delivery in councils' risk register—these risks need to be actively assessed and managed
9.	prepare a cash flow forecast of at least five years to better manage financial impacts of development contributions.

Also that local councils:

- include risks associated with development contributions and infrastructure asset delivery in councils' risk register—these risks need to be actively assessed and managed
- prepare a cash flow forecast of at least five years to better manage financial impacts of development contributions.

The Department of Environment, Land, Water and Planning has accepted our recommendations.

The Auditor-General will follow up with local councils over time.

Contact details

For further information on this presentation please contact:

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