



## **Norfolk Island Regional Council**

**Independent Audit of Financial Performance  
on behalf of the Department of Infrastructure, Transport,  
Regional Development and Communications**

**30 October 2020**



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## Executive Summary

The Department of Infrastructure, Transport, Regional Development and Communications engaged us to conduct a performance audit of the Norfolk Island Regional Council under Division 2A and Division 3 of Part 3 of Chapter 13 of the Local Government Act 1993 (NSW) (NI) in order to assist the Auditor-General to exercise their powers under that Act. The engagement covered the Council's financial performance for the period 1 July 2016 to 30 June 2020 (with consideration of the 2015-16 final Administration of Norfolk Island audit), cash and working capital positions, asset management plans, budgeting process and the use of the Civica Local Government System.

### Key findings

- Financial performance
  - Council's operating result before capital items deteriorated in 2019/20 to a deficit of \$1.8 million.
  - The budgeted operating result for 2020/21 is also a deficit before capital items of approximately \$121,000, however, this is subject to change following a major review as part of the first quarterly budget review for 2020/21.
  - User charges, fees and other revenue dropped by \$1.7 million for 2019/20, primarily due to the impact of the COVID-19 pandemic on tourism.
  - Council's funding result (i.e. funds moving in and out of Council) was a deficit of \$11.2 million for 2019/20, resulting in a fundamental decrease in Council's available working capital position.
  - Council's operating performance ratio of -6.56 for 2019/20 fell well short of the industry benchmark of 0% and is also forecast to be negative for 2020/21.
  - Council's percentage of outstanding rates and charges of 18% for 2019/20 did not meet the industry benchmark of less than 10% and is forecast to significantly worsen in 2020/21.
- Cash Position
  - Whilst Council held \$25.3 million in cash and investments as at 30 June 2020, most of the funds were restricted and committed to specific projects and liabilities.
  - Due to cost overruns for large projects and the level of committed funds, Council's unrestricted cash available to fund day to day operations was reduced to only \$646,000 as at 30 June 2020 (down from \$11.5 million for 2019).
  - The adopted budget for 2020/21 has forecast the cash position at 30 June 2021 to be \$799,000. This is considered insufficient to fund current trust balances and liabilities for employee leave entitlements, and therefore, would be insufficient to fund day to day operations.
  - Given the impact of the COVID-19 pandemic is ongoing and the nature of the current projects Council are undertaking, there is potential for Council to be in a negative cash position during 2020/21.
- Working Capital
  - Available working capital decreased during 2019/20 from \$13 million to \$1.8 million as at 30 June 2020.
  - The suggested minimum level of available working capital that Council should maintain is in the order of \$7 million.

- As such, the current level of available working capital is inadequate to fund day to day operations and provide an appropriate buffer against unforeseen or unbudgeted circumstances.
- Asset Management
  - Current asset management plans do not effectively address accepted minimum requirements in order to aid long term plans for asset rehabilitation/renewal and maintenance.
  - An asset management system is not currently in use to maintain the required asset data. However, Council is purchasing a new cloud based asset management program.
  - Since Council was formed, its level of expenditure for buildings and infrastructure renewals has never met the industry benchmark.
  - The 2020 external revaluation of buildings and infrastructure is expected to increase the depreciation charge for those assets by approximately \$1.9 million, meaning it will become even more challenging to achieve the industry benchmark for asset renewals.
  - The estimated cost to bring Council's existing buildings and infrastructure assets to a satisfactory standard is approximately \$10.3 million.
  - Based on this cost of \$10.3 million, Council's infrastructure backlog ratio is approximately 7% compared to the industry benchmark of less than 2%.
- Ledger Structure
  - As a system reporting tool is not in use, extensive data manipulation is required to meet some reporting requirements.
  - There is some inconsistency and redundant accounts within the current chart of accounts.
  - In the absence of staff training, there may be a lack of understanding across the organisation of which work orders to use when initiating transactions.
- Budgeting Process
  - Spreadsheets are used to prepare the annual budget and there is no formal documented process or manual in place to guide the preparation.
  - There appears to be little involvement of budget managers in the budgeting process, resulting in a lack of ownership and accountability to budgets.
  - There is a history of significant variances to original budgets.
- Local Government System and Processes
  - There is a general under-utilisation of the Civica system, with system modules included in Council's contract that are not used.
  - There are a number of manual registers and control documents in use. E.g. the use of Excel spreadsheets used for the fixed assets register and for calculating and maintaining employee leave balances.

## Conclusion

Whilst the COVID-19 pandemic has contributed greatly to Council's declining financial performance, the major impact on Council's diminished cash and working capital positions is the level of Council funds that have been spent or committed to major projects. When approving these projects, Council may not have fully understood the implications for Council's finances and how any potential overruns on these projects would be funded. Whilst the merits of the projects are not being questioned, nevertheless, Council's involvement in them and the overruns that ensued have caused Council to utilise the majority of its cash reserves.

Council's current asset management plans do not comply with accepted minimum requirements and do not contain sufficient information to guide long term plans for asset rehabilitation/renewal and maintenance.

Subject to the above comments, nothing further has come to our attention suggesting widespread failures in effectiveness, efficiency, economy, or compliance with relevant laws with respect to the matters covered in this report.

## Recommendations

Council should consider the findings in this report and develop strategies and plans to address Council's deteriorating financial position. Staff training is required across a number of areas of the organisation including financial and asset management, capabilities and use of the system and related processes, and budgeting. Further details of recommendations in addressing the key findings are outlined in the relevant sections of this report. Section 8 of the report also provides suggestions for improvement we identified during the course of our engagement in respect to the use of the system and internal procedures.

# 1. Introduction

## Background

The Norfolk Island Regional Council (Council) commenced on 1 July 2016 and consists of five Councillors who are elected for a four-year term. The Council is unique in that it provides local government services, runs several business enterprises and is contracted to provide Commonwealth funded state services such as: land titles registration, motor vehicle and drivers licensing, courts and legal services, companies registration and ports management.

The Council operates under the NSW local government framework, comprising the Local Government Act 1993 (NSW) (NI) (applied Local Government Act) and the Local Government (General) Regulation 2005 (NSW) (NI), as well as Norfolk Island continued laws.

The day to day management of Council is the responsibility of the General Manager who reports to the Councillors. The current General Manager commenced in January 2020, and through a series of internal reviews, and addressing challenges that have arisen due to the COVID-19 pandemic, Council unanimously resolved that a full audit of the finances and governance of the Council's operations be conducted and the Department of Infrastructure, Transport, Regional Development and Communications requested to manage the engagement. The relevant audit powers under the applied Local Government Act sit with the Commonwealth Minister responsible for Norfolk Island and their delegates. It was determined that a performance audit be conducted under Division 2A and Division 3 of Part 13 of the applied Local Government Act to cover governance, financial and operational matters as set out under the Scope of Audit section in the Terms of Reference.

This report covers the Financial Performance component of the Scope of Audit.

In the Mayoral Minute of 24 June 2020, the following challenges were noted that are relevant to the Financial Performance component of the Scope of Audit:

- Council has been provided poor information in many of their decision making processes by previous management.
- Existing contractual obligations will exhaust Council's entire cash position and the financial position for 30 June 2021 will be zero cash in reserve.
- Council's revenue streams are so reliant on the Tourism economy; and a review must be undertaken to improve resilience and sustainability.
- Council employees require training and support to make sure Council's systems are operationally efficient.

## Scope and approach

In respect to Financial Performance, the Terms of Reference requires consideration and advice on:

- The financial performance of the Council for the following financial years: 2016/17; 2017/18; 2018/19; 2019/20, with consideration of the 2015/16 final Administration Audit.
- Council's cash position, considering contractual commitments, overruns, legal disputes and Covid-19 impacts.
- The minimum level of working capital the Council should maintain.
- Current asset management plans and identification of any financial gap in the minimum accepted standard of assets (road, water, wastewater, buildings, footpaths, ancillary road assets, and stormwater).
- Council's ledger structure and its effectiveness, including the use of work orders.
- Moving the budgeting process from spreadsheets to a web-based solution.

- Possible improvements to the Civica Local Government System and the use of the following models to optimise the efficiency of the Council's operations, being the Plant Asset system, the distribution of overheads, Stores system, Online Ordering, Purchase Cards, Operation of external trust accounts held by Council, Payroll System, and Asset Management .

Under the applied Local Government Act, a performance audit is to determine whether the Council is carrying out its activities effectively, economically and efficiently, and in compliance with all relevant laws.

Our procedures included:

- Interviewing Council staff
- Consulting with relevant stakeholders
- Examining Council reports, policies and plans
- Reviewing and analysing financial information
- Examining reconciliations, schedules and supporting documentation .

Financial information covering a number of periods is presented throughout this report. This information has primarily been obtained from the audited financial statements. It should be noted that the financial information relating to the year ended 30 June 2020 has been obtained from the 2019/20 draft financial statements that have not yet been subject to external audit and are subject to change. Similarly, the projected financial information relating to the year ending 30 June 2021 has been obtained from the budgeted results contained in the adopted 2020/21 Operational Plan. We understand that the 2020/21 budget was prepared over a two week period in April 2020 with little input from budget managers. Some estimation of the impacts of the COVID-19 pandemic were factored into the 2020/21 budget, however, the first quarterly budget review for 2020/21 will be a major review. For example, the 2020 external valuation of Council's buildings and infrastructure assets was not finalised at the time the 2020/21 budget was prepared and the valuation indicates that Council's depreciation expense will increase by approximately \$1.9 million for 2020/21.

This report, and our findings and recommendations, should be read in light of the above information.

### **General observations**

Since its formation, Council has experienced high levels of staff turnover; particularly of professional staff in the areas of finance, human resources, planning, and asset management. In respect to finance, there have been several Chief Financial Officers, with the longest tenure being approximately two years. There has also been high turnover of other accounting/finance officers that support the Chief Financial Officer position. We understand that two financial/management accountants with relevant local government experience have recently been appointed to support the current Chief Financial Officer. We also understand that Council's previous Asset Manager/Engineer left the organisation some nine months ago and has not yet been replaced. The high staff turnover appears to have created a lack of corporate and system knowledge across the organisation. During our review, it was noted that some requested information was either difficult to locate or could not be located by current staff.

### **Acknowledgments**

We gratefully acknowledge the co-operation and assistance provided by the Council's General Manager, Chief Financial Officer, and other staff.

## 2. Financial Performance

### Background

The Terms of Reference requires a review of the financial performance of the Council for the following financial years: 2016/17; 2017/18; 2018/19; 2019/20, with consideration of the 2015/16 final Administration audit.

We have reviewed and analysed the final audited financial statements of the Administration of Norfolk Island for the year ended 30 June 2016, audited financial statements of the Council for the years ended 30 June 2017, 2018 and 2019, the draft financial statements for the year ended 30 June 2020, the Operational Plan for the year ending 30 June 2021, and other information as considered necessary. In assessing Council's financial performance, we have considered Council's operating results and performance against industry benchmarks over the relevant period. The financial reporting and performance measures discussed are specific to local government entities, so the results for the period prior to Council's formation have only been included as applicable.

### Income Statement

The Income Statement is one of the primary financial statements that shows the Council's profit or loss over a period of time. The profit or loss is determined by taking all revenues and subtracting all expenses. The Income Statement also discloses Council's original adopted budget to provide a comparison to actual results. The table in Exhibit 1 sets out the Council's operating results for each year and the extent (%) that each category of revenue and expenses contributed to the total. The current forecast result for 2020/21 is also provided for information purposes (noting the comments in the Introduction section of the report).

**Exhibit 1: Income Statement 2017-2021**

Income Statement	2017		2018		2019		2020		2021	
	\$000	%	\$000	%	\$000	%	\$000	%	\$000	%
<b>Revenues before capital items</b>										
Rates & annual charges	1,177	5%	1,691	6%	1,603	6%	1,382	5%	1,506	6%
User charges, fees & other revenues	16,859	75%	18,898	71%	19,304	68%	17,580	64%	15,835	59%
Grants & contributions provided for operating purposes	4,073	18%	5,554	21%	6,902	24%	8,395	30%	9,050	34%
Interest & investment revenue	247	1%	299	1%	398	1%	259	1%	332	1%
	<b>22,356</b>	<b>100%</b>	<b>26,442</b>	<b>100%</b>	<b>28,207</b>	<b>100%</b>	<b>27,616</b>	<b>100%</b>	<b>26,723</b>	<b>100%</b>
<b>Expenses</b>										
Employee benefits & costs	7,316	3%	9,079	34%	10,172	36%	11,538	39%	10,545	39%
Materials, contracts & other expenses	11,964	50%	12,492	47%	13,081	47%	13,265	45%	11,971	45%
Depreciation & amortisation	4,605	19%	4,847	18%	4,841	17%	4,624	16%	4,328	16%
	<b>23,885</b>	<b>100%</b>	<b>26,418</b>	<b>100%</b>	<b>28,094</b>	<b>100%</b>	<b>29,427</b>	<b>100%</b>	<b>26,844</b>	<b>100%</b>
<b>Net operating result before capital items</b>	<b>(1,529)</b>		<b>24</b>		<b>113</b>		<b>(1,811)</b>		<b>(121)</b>	
Grants & contributions provided for capital purposes	-		-		13,500		33,833		8,164	
<b>Net operating result</b>	<b>(1,529)</b>		<b>24</b>		<b>13,613</b>		<b>32,022</b>		<b>8,043</b>	



Significant net operating surpluses were achieved for 2019 and 2020, however, these results were due to the receipt of significant amounts of grant funding for capital projects. As these funds can only be used for the specific capital projects for which the funds were provided, it is more relevant to consider Council's net operating result before capital revenue. Following a modest surplus before capital items in 2019, there has been a significant deterioration in the result for 2020; a deficit of \$1.8 million.

A generally accepted industry benchmark is to achieve a net surplus before capital items to allow Council to fund day to day operations and provide sufficient funds for maintaining and renewing Council's infrastructure, property, plant and equipment.

The decrease in the result before capital items for 2020 was largely driven by increased employment costs and reduced income from rates (\$221,000) and other revenues (\$ 1.7 million).

As Council has a relatively small rating base, with rates and annual charges representing only 5-6% of total revenue, there is a great reliance on operating grants (financial assistance and Service Delivery Agreement) and other revenue to fund Council's operations. The reliance on operating grants has steadily increased over the last four years and now represents approximately 30% of Council's total revenue. User charges, fees and sundry revenue for 2020 was down \$1.7 million to \$17.6 million, compared to a budget of \$22.4 million. Given Council's reliance on the tourism economy, it is evident that the COVID-19 pandemic has heavily impacted Council's revenues and operating result. Sundry revenue is summarised in the Revenue section below.

## Revenue

Exhibit 2 provides a summary of Council's revenue (excluding rates and grants) over the period under review and the movement in 2020 from the previous year.

### Exhibit 2: Revenue excluding rates and grants 2017-2020

Revenue	2017		2018		2019		2020		2020 Movement	
	\$000	%	\$000	%	\$000	%	\$000	%	\$000	%
<b>Excluding rates and grants</b>										
Waste management	614	4%	693	4%	803	4%	817	5%	14	2%
Statutory/regulatory charges	1915	11%	2,912	15%	2,519	13%	2,129	12%	(390)	(15)%
Aerodrome	1,807	11%	2,461	13%	3,230	17%	2,546	14%	(684)	(21)%
Quarry income	372	2%	146	1%	36	0%	240	1%	204	567%
Tourism/sales	46	0%	174	1%	200	1%	115	1%	(85)	(43)%
Electricity charges	2,338	14%	2,803	15%	3,202	17%	3,152	18%	(50)	(2)%
Lighterage charges	550	3%	618	3%	625	3%	468	3%	(157)	(25)%
Telecom sales	3,518	21%	3,603	19%	3,153	16%	2,772	16%	(381)	(12)%
E-Tops (aerodrome)	350	2%	168	1%	23	0%	-	0%	(23)	(100)%
Gaming revenue	700	4%	124	1%	164	1%	165	1%	1	1%
Liquor Bond sales	3,949	23%	4,036	21%	4,091	21%	4,193	24%	102	2%
KAHVA sales/entry fees	285	2%	294	2%	292	2%	250	1%	(42)	(14)%
Rental income	111	1%	563	3%	564	3%	598	3%	34	6%
Others	304	2%	303	2%	402	2%	135	1%	(267)	(66)%
	<b>16,859</b>	<b>100%</b>	<b>18,898</b>	<b>100%</b>	<b>19,304</b>	<b>100%</b>	<b>17,580</b>	<b>100%</b>	<b>(1,724)</b>	<b>(9)%</b>

As noted above, Council's other revenue (excluding rates and grants) for 2020 was down \$1.7 million to \$17.6 million (2019: \$19.3 million) compared to a budget of \$22.4 million. Council's revenue has been impacted both directly and indirectly by the COVID -19 pandemic with tourism related revenue particularly effected. For example, airport revenue for 2020 was down approximately \$684,000 (21%) to \$2.5 million (2019: \$3.2 million) compared to a budget of \$3.4 million.

In March 2020, Council also announced that it would waive up to \$500,000 in Council fees to assist members of the community during the State of Emergency, which has also directly impacted Council revenues. The estimated cost of the community assistance was reported to the Council meeting of 20 May 2020 as follows:

Description	Value	Budget Cost
Electricity	20%	\$172,600
Water assurance	100%	\$167,082
Lighterage	20%	\$12,000
Phone	\$50	\$55,000
Radio Advertising	100%	\$10,500
<b>Subtotal</b>		<b>\$417,182</b>
Land Rates	20%	\$60,000
Waste Booklet	\$20	\$32,200
Waste Commercial	100%	\$5,360
Merchant Fees	100%	\$5,000
<b>Subtotal</b>		<b>\$102,560</b>
<b>Total</b>		<b>\$519,742</b>

## Funding Result

As the operating result shown in the Income Statement only accounts for operating income and expenditure, and in reviewing the overall financial performance of Council, it is useful to consider the total source of revenues and how they were applied during the year. The Funding Result represents the movement in Council's Available Working Capital balance during the year and is illustrated in Exhibit 3.

### Exhibit 3: Funding result 2017-2020

<b>Funding Result</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>
	\$000	\$000	\$000	\$000
<b>Funds were provided by:-</b>				
<b>Operating Result</b>	<b>(1,529)</b>	<b>24</b>	<b>13,613</b>	<b>32,022</b>
Equity adjustment upon the adoption of new accounting standards	-	-	-	(2,500)
Add back non funding items:-				
- Depreciation & amortisation	4,605	4,847	4,841	4,624
- Airport loan waiver - Norfolk Island resurfacing	-	-	(10,900)	-
- Other items	(531)	-	-	365
	2,545	4,871	7,554	34,511
Decrease/Redemption of non-current investments	-	-	4,000	-
Transfers from externally restricted assets (net)	-	798	-	2,794
	<b>2,545</b>	<b>5,669</b>	<b>11,554</b>	<b>37,305</b>
<b>Funds were applied to:-</b>				
Purchase and construction of assets	(1,842)	(1,819)	(4,829)	(39,697)
Increase/purchase in non-current investments	-	(4,000)	-	-
Principal repaid on loans	(377)	(286)	(100)	-
Transfers to externally restricted assets (net)	(798)	-	(3,056)	-
Transfers to internal reserves (net)	-	(237)	(3,057)	(8,835)
	<b>(3,017)</b>	<b>(6,342)</b>	<b>(11,042)</b>	<b>(48,532)</b>
<b>Increase/(Decrease) in Available Working Capital</b>	<b>(472)</b>	<b>(673)</b>	<b>512</b>	<b>(11,227)</b>
Available Working Capital - Start of Year	13,610	13,138	12,465	12,977
<b>Available Working Capital - End of Year</b>	<b>13,138</b>	<b>12,465</b>	<b>12,977</b>	<b>1,750</b>

As can be seen from the table above, Council's funding result has been a deficit each year except 2019. These deficits represent reductions in Council's Available Working Capital, being the funds available to fund day to day operations.

After adding back non-cash items such as depreciation to the operating result, approximately \$37.3 million of funds were provided in 2020. These funds were applied to the purchase and construction of assets (including the airport pavement repair and resurfacing project) and setting aside internally restricted reserves to fund liabilities and ongoing capital works. The overall funding result was a deficit of \$11.2 million, leaving a balance of Available Working Capital of \$1.8 million at 30 June 2020. The balance of Available Working Capital is a liquidity measure determined by deducting all externally and internally restricted assets and liabilities from Council's net asset position is discussed further in the Working Capital section of this report.

## Statement of Cash Flows

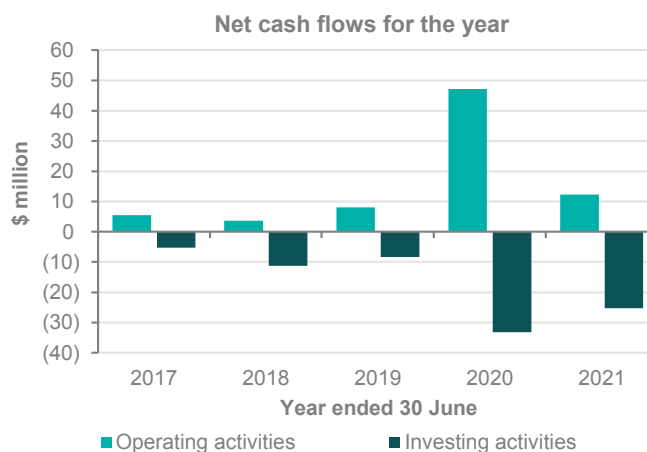
### Exhibit 4: Statement of Cash Flows 2017-2021

The Statement of Cash Flows illustrates the flow of cash and cash equivalents moving in and out of Council during the year.

Cash flows are categorised into operating, investing and financing activities.

Investing activities primarily relate to the purchase/construction of infrastructure, property, plant and equipment.

Financing activities include the receipt and repayment of borrowings. These have not been included in the accompanying graph as financing activities are not significant to this Council.



The Statement of Cash Flows revealed that cash and cash equivalents increased by \$1.3 million to \$15.3 million as at the close of 2020. The graph above demonstrates the significant receipt of grant funding for capital projects and the expenditure of those funds for the purchase and construction of assets during 2020, and continuing in 2021.

In addition to cash and cash equivalents, Council also held investments in term deposits of \$10 million; giving a total of \$25.3 million of cash and investments as at 30 June 2020. It should be noted that the majority of these funds are restricted in use and this is discussed later in the Cash Position section of this report.

## Performance Measures

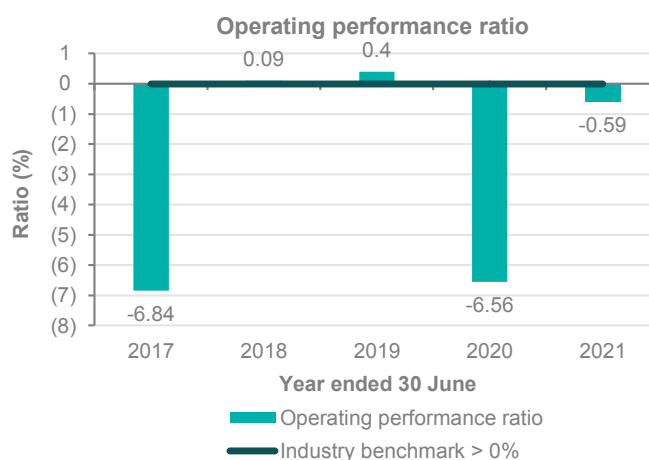
This section provides an overview of the Council's performance against industry benchmarks for six key performance measures.

- Operating performance ratio**

**Exhibit 5: Operating performance ratio 2017-2021**

The 'operating performance ratio' measures the ability of Council to contain operating expenditure within operating revenue (excluding capital grants and contributions).

The industry benchmark is greater than 0%.



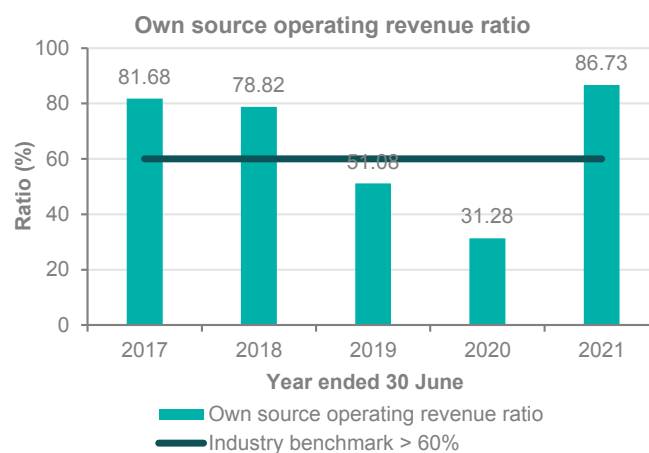
Whilst the industry benchmark was achieved in 2018 and 2019, Council did not meet the industry benchmark for 2020 due to the significant operating deficit before capital revenue that was recorded (as discussed in the Income Statement section). It is noted that Council's original budget for 2021 discloses a forecast deficit before capital items of \$121,000. Accordingly, the industry benchmark is not expected to be met for 2021.

- Own source operating revenue ratio**

**Exhibit 6: Own source operating revenue ratio 2017-2021**

The 'own source operating revenue ratio' measures the Council's degree of reliance on external funding sources such as operating grants and contributions.

The industry benchmark is greater than 60%.



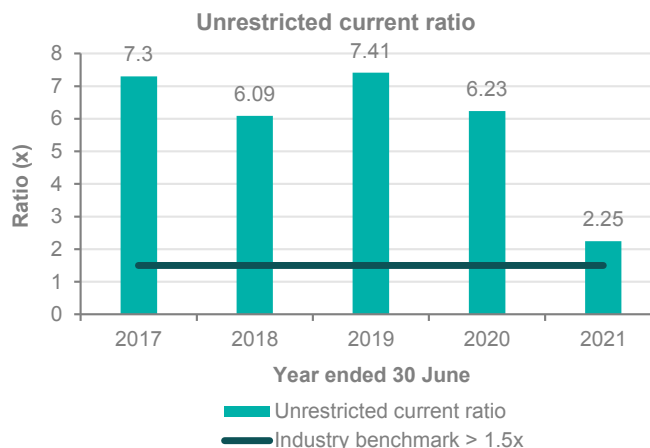
As this indicator fluctuates with movements in grants and contributions, and Council received significant amounts of additional grant funding in 2019 and 2020, Council did not meet the industry benchmark for those years.

- **Unrestricted current ratio**

#### Exhibit 7: Unrestricted current ratio 2017-2021

The 'unrestricted current ratio' is a liquidity ratio specific to local government and represents Council's ability to meet its short-term obligations as they fall due. Restrictions placed on funding sources (e.g. grants) complicate the traditional current ratio, so the unrestricted ratio is preferred as it excludes cash that cannot be used to meet Council's operating costs.

The industry benchmark is greater than 1.5 times.



Council has consistently exceeded the industry benchmark for this indicator. However, this indicator only takes into consideration externally imposed restrictions on the use of funds (e.g. unspent grant funds) and does not consider internally imposed restrictions (being funds set aside by Council decision). Hence, it is relevant to consider this indicator in conjunction with Council's overall cash and working capital positions, discussed later in this report. It is noted that the unrestricted current ratio is budgeted to drop significantly for 2021 as Council's funds are depleted.

- **Debt service cover ratio**

The 'debt service cover ratio' measures the availability of operating cash to service debt including interest, principal and lease payments. The industry benchmark is greater than 2 times.

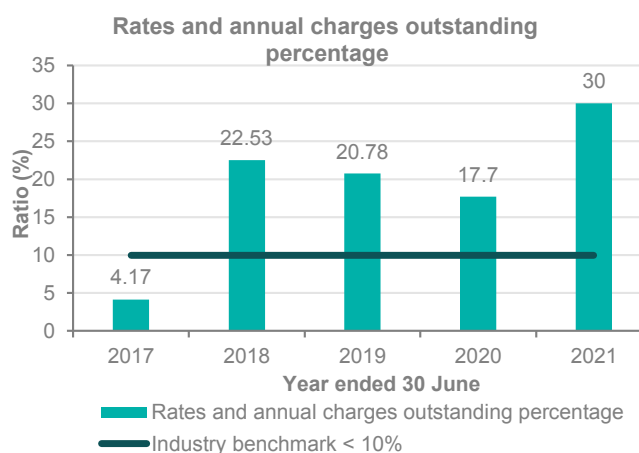
Council is currently free of debt. Accordingly, no further commentary on this performance measure is necessary.

- **Rates and annual charges outstanding percentage**

**Exhibit 8: Rates and annual charges outstanding percentage 2017-2021**

The 'rates and annual charges outstanding percentage' assesses the impact of uncollected rates and annual charges on Council's liquidity and the adequacy of debt recovery efforts.

The industry benchmark for regional councils is less than 10%.



As at 30 June 2020, arrears of rates and annual charges stood at approximately \$321,000 (2019: \$419,000) and represented 18% (2019: 21%) of the amount collectible. Whilst this represents an improvement from the previous year, the percentage outstanding is well beyond the accepted industry benchmark of 10%.

It is also noted that revenue from rates and annual charges decreased by approximately \$221,000 during the financial year 2019/20. This would appear to be the main reason for the decrease in outstanding rates as opposed to improved collections.

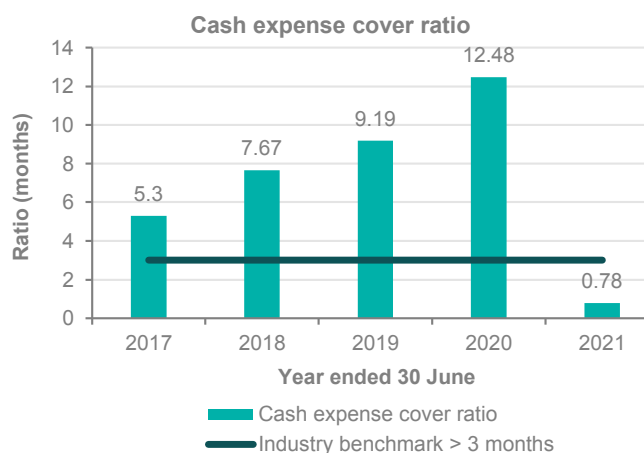
The budget adopted in the 2020/21 Operational Plan indicates that outstanding rates are forecast to increase. It is important that Council carefully monitor the accumulation of outstanding debts and perform appropriate collection activities.

- **Cash expense cover ratio**

**Exhibit 9: Cash expense cover ratio 2017-2021**

The 'cash expense cover ratio' is another liquidity ratio indicates the number of months the Council can continue paying for its immediate expenses without additional cash inflow.

The industry benchmark is greater than 3 months.



Council has consistently exceeded the industry benchmark for this indicator due to the historically high levels of cash and cash equivalents held. It is noted, however, that the calculation of this indicator does not factor in any restrictions on the use of the funds. It also noted that this indicator is budgeted to fall well below the industry benchmark for 2021 as Council's cash reserves are spent.

### Key findings

- Council's operating result before capital items deteriorated in 2019/20 to a deficit of \$1.8 million.
- The budgeted operating result for 2020/21 is also a deficit before capital items of approximately \$121,000, however, this is subject to change following a major review as part of the first quarterly budget review for 2020/21.
- User charges, fees and other revenue dropped by \$1.7 million for 2019/20, primarily due to the impact of the COVID-19 pandemic on tourism.
- Council's funding result (i.e. funds moving in and out of Council) was a deficit of \$11.2 million for 2019/20, resulting in a fundamental decrease in Council's available working capital position.
- Council's operating performance ratio of -6.56 for 2019/20 fell well short of the industry benchmark of 0% and is also forecast to be negative for 2020/21.
- Council's percentage of outstanding rates and charges of 18% for 2019/20 did not meet the industry benchmark of less than 10% and is forecast to significantly worsen in 2020/21.

### Recommendations

- To achieve industry benchmarks and improve financial performance, Council should budget to achieve a net operating surplus before capital revenue.
- Given the current uncertainty over Council's revenue streams, Council should consider opportunities for reducing operating costs. We understand that Council has implemented an organisational restructure, including redundancies for twenty permanent roles and a significant reduction in casuals and non-replacement of some vacant positions. It is expected to generate cost savings of approximately \$2 million per annum. Council has also recently determined to purchase new batteries and generators for the Norfolk Island power house with a view to reducing diesel fuel costs.
- Council should carefully monitor the accumulation of outstanding rates and other debts and perform appropriate collection activities.



### 3. Cash Position

#### Background

The Terms of Reference requires consideration of Council's cash position, considering contractual commitments, overruns, legal disputes and COVID-19 impacts.

#### Cash and Investments

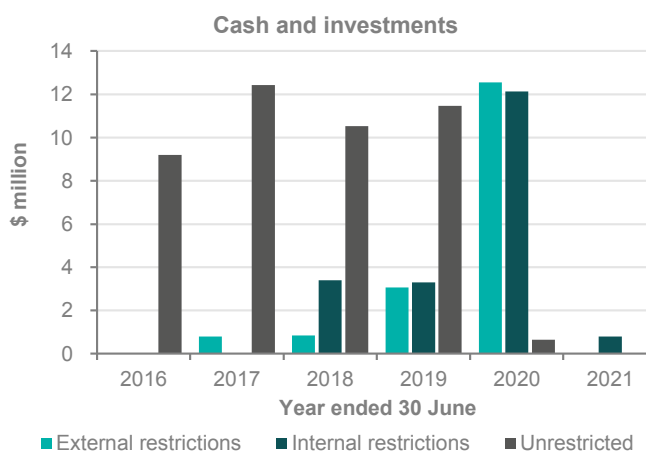
Exhibits 10 and 11 provide a summary of Council's cash position at each balance date since it was formed and the budgeted balance at 30 June 2021.

##### Exhibit 10: Cash and investments 2016-2021

Cash and Investments	1 July 2016	2017	2018	2019	2020	2021
	\$000	\$000	\$000	\$000	\$000	\$000
External Restrictions	-	798	841	3,056	12,562	-
Internal Restrictions	-	-	3,396	3,294	12,129	799
Unrestricted	9,191	12,425	10,536	11,473	646	-
<b>Total cash and investments</b>	<b>9,191</b>	<b>13,223</b>	<b>14,773</b>	<b>17,823</b>	<b>25,337</b>	<b>799</b>

##### Exhibit 11: Cash and investments 2016-2021

- External restrictions include unspent specific purpose grants and funds held in trust.
- Balances are internally restricted due to Council policy or decisions for forward plans including works program.
- Unrestricted balances provide liquidity for day-to-day operations.



Total cash and investments held at 30 June 2020 amounted to \$25.3 million. Of this balance, \$12.6 million represented externally restricted funds including unspent grant funding for the airport pavement repair and resurfacing project, desalination plant, hospital generator, and airport security equipment. These funds can only be used for those specific projects.

Council has also set aside its own funds in internal restrictions of \$12.1 million to fund liabilities (e.g. employment leave entitlements) and ongoing projects. These include \$4.2 million of Council funds to be put towards the airport pavement repair and resurfacing project, an additional \$3.9 million for road works, and \$734,000 for the Future Proofing Telecommunications project.

After subtracting both external and internal restrictions, the remaining balance represents unrestricted balances to fund day to day operations. Council has historically held a significant amount of unrestricted cash and investments since its formation. However, due to Council committing significant amounts of

its own funds (in addition to grant funding) to large projects and the impacts of the COVID -19 pandemic, Council's unrestricted cash and investments have been severely diminished and stood at \$646,000 at 30 June 2020.

Council's adopted 2021 budget projected Council's total cash to be only \$799,000 as at 30 June 2021. Based on the 2020 financial statements and current information available, this cash balance would not be sufficient to cover current trust balances and employee leave entitlements. Accordingly, there would be insufficient cash to fund day to day operations. It is also noted that the full financial impact of the ongoing COVID-19 pandemic is not fully known at this stage, so the 2021 projected cash position may be worse than budgeted for. Other factors relevant when considering Council's cash position are noted below.

### Other factors

When assessing Council's ongoing cash position, the following matters should be considered.

- Contractual commitments**

The 2019/20 financial statements disclose total capital commitments as at 30 June 2020 of \$13.1 million; to be funded from future grants (\$1.4 million), externally restricted funds (\$2.5 million) and internally restricted reserves (\$9.2 million). The majority of the capital commitments relate to the airport pavement repair and resurfacing project and additional road works, and the Future Proofing Telecommunications project. It is noted that the amounts to be funded from external restrictions and internal reserves have already been accounted for in the cash position for 2020 as noted above.

Subsequent to 30 June 2020, Council has signed a contract for new batteries for the Norfolk Island power house worth approximately \$1.9 million. The tender process for this commenced in June 2020 and Council is also considering purchasing 1 to 2 small generators for approximately \$300,000 as part of this project.

Council has also agreed to engage an external company to run the November election at a cost of \$150,000 that was not budgeted for.

- Overruns**

Whilst known funding requirements for ongoing major projects have already been accounted for in Council's cash position as at 30 June 2020, it is worth considering the impact of budget overruns that such projects have had on Council's finances.

### Exhibit 12: Major project overruns

Project Overruns	Airport Pavement Repair and Resurfacing	Future Proofing Telecommunications
	\$000	\$000
Building Better Regions Funding (Commonwealth)	43,000	3,450
Norfolk Island Regional Council contribution (A)	1,976	1,150
Original project budget	44,976	4,600
Total project expenditure forecast (current)	48,962	5,310
Budget overruns borne by Council (B)	3,986	710
Total Council contribution (A) + (B)	<b>5,962</b>	<b>1,860</b>

As can be seen in the table above, Council had originally committed its own funds of \$3.1 million across the two projects. Project completion forecasts currently suggest that the total expenditure on these projects will exceed the original budgets by approximately \$4.7 million, meaning Council's total contribution will exceed \$7.8 million.

We understand that Council was also negotiating an additional \$5 million road works contract with the contractor for the airport pavement repair and resurfacing project in July 2019. Given the funds that Council has either spent or committed to spend across these projects a mount to approximately \$12.8 million, it is clear that these projects have exhausted Council's cash reserves.

When approving these projects, Council may not have fully understood the implications for Council's finances and how any potential overruns on these projects would be funded. Management has recently prepared detailed project expenditure forecasts that have identified the cost overruns noted above .

- **Legal disputes**

We have not become aware of any significant outstanding legal disputes during our review that would significantly impact our findings.

- **COVID-19 impact**

Based on our review and discussions with management, the financial impact of the COVID-19 pandemic is reflected in the 2019/20 financial statements and the ongoing impact generally reflected in the adopted budget for 2020/21 budget. However, there is currently significant uncertainty regarding the impact on tourism and, therefore, Council's finances moving forward. We understand management are continuing to compile information for the first quarterly budget review which is expected to require significant changes to the 2020/21 budget.

## **Key findings**

- Whilst Council held \$25.3 million in cash and investments as at 30 June 2020, most of the funds were restricted and committed to specific projects and liabilities.
- Due to cost overruns for large projects and the level of committed funds, Council's unrestricted cash available to fund day to day operations was reduced to only \$646,000 as at 30 June 2020 (down from \$11.5 million for 2019).
- The adopted budget for 2020/21 has forecast the cash position at 30 June 2021 to be \$799,000. This is considered insufficient to fund current trust balances and liabilities for employee leave entitlements, and therefore, would be insufficient to fund day to day operations.
- Given the impact of the COVID-19 pandemic is ongoing and the nature of the current projects Council are undertaking, there is potential for Council to be in a negative cash position during 2020/21.

## **Recommendations**

- Council needs to restore its cash position to ensure it has sufficient cash to adequately cover trust balances and liabilities for employee leave entitlements , fund day to day operations and meet its obligations as they fall due. This may be achieved through:
  - Budgeting for and achieving cash surpluses
  - Ensuring expenditure budgets are closely monitored and managed
  - Carefully monitoring the accumulation of outstanding debts and ensuring appropriate recovery action is taken
  - Borrowing – whilst Council is currently debt free and does have the ability to borrow under the Local Government Act, it not generally recommended to borrow for operational purposes. Any consideration of borrowing would also need to take into

account Council's ability to service the debt. It is also noted that borrowing is a charge on the income of Council and the current uncertainty over Council's income streams may limit the Council's ability to borrow.

- The receipt of an injection of additional government funding.
- Given that overruns on major projects have greatly contributed to the depletion of Council's reserves, it is important that:
  - Council ensure that it fully understands the implications on its finances in both the short and long term before approving projects
  - Project budgets include an appropriate allowance for contingencies and how these would be funded
  - Projects budgets be carefully monitored and managed.

## 4. Working Capital

### Background

The Terms of Reference requires consideration of the minimum level of working capital the Council should maintain.

### Available working capital position

Available working capital is a liquidity measure determined by deducting all externally and internally restricted assets and liabilities from Council's net asset position.

Exhibit 13 summaries Council's available working capital position at each balance date since it was formed and the budgeted balance at 30 June 2021.

#### Exhibit 13: Available working capital position 2016-2021

Available Working Capital	1 July 2016	2017	2018	2019	2020	2021
	\$000	\$000	\$000	\$000	\$000	\$000
<b>Net Current Assets (Working Capital) per Financial Statements</b>	<b>13,147</b>	<b>13,650</b>	<b>12,502</b>	<b>19,327</b>	<b>14,141</b>	<b>2,636</b>
<b>Add:</b> Current loan repayments budgeted to pay	463	286	200	-	-	-
<b>Less:</b> Externally restricted net assets - current	-	(798)	-	(3,056)	(262)	-
<b>Less:</b> Internally restricted assets - current	-	-	(237)	(3,294)	(12,129)	(799)
<b>Available Working Capital as at 30 June</b>	<b>13,610</b>	<b>13,138</b>	<b>12,465</b>	<b>12,977</b>	<b>1,750</b>	<b>1,837</b>

As can be seen from the table above, Council's working capital position remained relatively stable from 2017 to 2019. Due to the factors outlined earlier in the Financial Performance (Funding Result) section of report, Council's available working capital position dropped by approximately \$11.2 million to \$1.8 million at 30 June 2020.

It is noted that the determination of net assets and externally restricted net assets has changed for 2020 due to the adoption of new accounting standards issued by the Australian Accounting Standards Board that were applicable from 1 July 2019. However, this has only impacted the categorisation of amounts between line items in the table above and does not alter the overall available working capital position.

### Target minimum available working capital

Available Working Capital is a liquidity measure that is not subject to an industry benchmark and take into account Council's specific circumstances. As a rule of thumb, it should be at a level to manage Council's day to day operations including the financing of debtors and inventories, and to provide a buffer against unforeseen and unbudgeted expenditures. Norfolk Island Regional Council is unique as it provides not only traditional local government services, but also runs several business enterprises and is contracted to provide Commonwealth funded state services such as: land titles registration, motor vehicle and drivers licensing, courts and legal services, companies registration and ports management. It also operates the utilities and communication services for the Island. Taking this into consideration, it was considered appropriate to incorporate a significant buffer for unforeseen or unbudgeted circumstances in determining the minimum level of available working capital that Council should maintain.

Based on the above, it is suggested that Council maintain a minimum available working capital balance of approximately \$7 million. This is represented in the calculation in Exhibit 14 which draws information from the annual financial statements.

#### Exhibit 14: Minimum working capital

Minimum Working Capital	2018	2019	2020
	\$000	\$000	\$000
Receivables	2,290	1,940	1,725
Inventories	2,004	2,104	2,033
	4,294	4,044	3,758
Unfunded bonds, deposits and retentions	675	409	433
	4,969	4,453	4,191
Buffer for unforeseen circumstances - 50%	2,485	2,227	2,096
<b>Calculated Minimum Working Capital</b>	<b>7,454</b>	<b>6,680</b>	<b>6,287</b>

**Three year average: 6,807**

**Suggested minimum: 7,000**

#### Exhibit 15: Available working capital

The accompanying graph shows Council's available working capital balance at each balance date compared to the minimum level suggested above.



As can be seen from the graph above, Council's available working capital balance dropped significantly during 2020 as funds were spent or committed to ongoing projects. The balance as at 30 June 2020 of \$1.8 million is well below the suggested minimum level of \$7 million. The adopted budget for 2021 suggests this will continue to be the case without intervention.

#### Key findings

- Available working capital decreased during 2019/20 from \$13 million to \$1.8 million as at 30 June 2020.
- The suggested minimum level of available working capital that Council should maintain is in the order of \$7 million.

- As such, the current level of available working capital is inadequate to fund day to day operations and provide an appropriate buffer against unforeseen or unbudgeted circumstances.

## **Recommendations**

- Council needs to restore its working capital position to ensure it has sufficient resources to fund day to day operations and to provide a buffer against unforeseen and unbudgeted expenditures.

This may be achieved through:

- Budgeting for and achieving funding surpluses.
- Ensuring expenditure budgets are closely monitored and managed.
- Borrowing – whilst Council is currently debt free and does have the ability to borrow under the Local Government Act, it not generally recommended to borrow for operational purposes. Any consideration of borrowing would also need to take into account Council's ability to service the debt. It is also noted that borrowing is a charge on the income of Council and the current uncertainty over Council's income streams may limit the Council's ability to borrow.
- The receipt of an injection of additional government funding.

## 5. Asset Management

### Background

The Terms of Reference requires consideration of current asset management plans and identification of any financial gap in the minimum accepted standard of assets (road, water, wastewater, buildings, footpaths, ancillary road assets, and stormwater).

### Asset management plans

Section 403 of the Local Government Act requires councils to have a resourcing strategy that incorporates asset management planning. The Act specifically required Norfolk Island Regional Council to have a resourcing strategy by 1 January 2017. The following Asset Management Plans were adopted by Council in June 2019 for Buildings, Infrastructure, Roads, and Fleet.

The publication Integrated Planning and Reporting Manual for local government in NSW is a resource that can be used to assess the adequacy of Asset Management Plans. We have reviewed Council's four Asset Management Plans against the Essential Elements outlined in the manual and noted the following:

- The Asset Management Strategy and Plan/s must be for a minimum timeframe of 10 years  
Level of compliance: satisfactory  
Council's plans cover the period 2020 to 2029.
- The Asset Management Strategy must include an overarching council endorsed Asset Management Policy  
Level of compliance: satisfactory  
Council adopted its Asset Management Policy (policy 4.04) in 2018.
- The Asset Management Strategy must identify assets that are critical to the council's operations and outline the risk management strategies for these assets  
Level of compliance: unsatisfactory  
This has not been effectively addressed in the plans. The plans for buildings, infrastructure, and roads provide a definition of critical assets but the assets are not identified and risk management strategies are not documented.
- The Asset Management Strategy must include specific actions required to improve the council's asset management capability and projected resource requirements and timeframes  
Level of compliance: unsatisfactory  
This has not been effectively addressed in the plans.
- The Asset Management Plan/s must encompass all the assets under a council's control  
Level of compliance: satisfactory  
The plans for buildings and infrastructure include tables noting the asset classes covered by the plans. The plans for roads and fleet include detailed lists of assets.
- The Asset Management Plan/s must identify asset service standards  
Level of compliance: unsatisfactory  
The plans provide very limited commentary on levels of service and note that customer expectations and desired service levels will be considered in later versions of the plans.



- The Asset Management Plan/s must contain long term projections of asset maintenance, rehabilitation and replacement costs  
Level of compliance: unsatisfactory  
The plans for buildings and infrastructure note this will be included in later versions of the plans. Graphs are provided for the projection of future projection of capital expenditure, however, these are quite limited. The plan for roads includes future budget allocations for maintenance and rehabilitation. However, it is unclear whether this is consistent with Council's budgets, and no supporting data could be located.
- Councils must report on the condition of their assets in their annual financial statements  
Level of compliance: not compliant  
The plans for buildings, infrastructure and fleet include high level tables noting the condition profile of various asset classes, however, no supporting data or workings could be located. The plan for roads includes a detailed table noting the conditions of road assets that appears to be based on 2017 inspections. It is noted that the external valuer engaged to value all classes of Council's infrastructure assets provided condition assessments as part of the process.

NSW councils are required to report the condition of assets via a Report on infrastructure assets included in the annual financial statements per the Local Government Code of Accounting Practice and Financial Reporting. As the Act and Regulation applicable to Norfolk Island Regional Council requires the adoption of all requirements in force in NSW, it would be expected that this report be prepared and included in the annual financial statements. It is noted that this report is not required to be audited and Council may not have historically maintained sufficient data to facilitate the preparation of the report.

Based on the above review of Council's Asset Management Plans against the Essential Elements of the Integrated Planning and Reporting Manual for local government in NSW, the status of Council's asset management strategies is considered immature.

## **2020 revaluation**

Council engaged an external valuer to revalue Council's buildings and infrastructure asset classes during 2020 in accordance with accounting standards for the purposes of financial reporting for the year ended 30 June 2020. Minor asset classes such as plant and equipment were not required to be revalued.

The result of the revaluation is summarised in Exhibit 16.

**Exhibit 16: Impact of 2020 asset revaluation**

<b>2020 Revaluation</b>	<b>Fair value</b>	<b>Pre- valuation net carrying amount</b>	<b>Increase in asset value</b>	<b>2021 Estimated depreciation</b>	<b>2020 Depreciation</b>	<b>Future increase in depreciation</b>
<b>Asset Class</b>	<b>\$000</b>	<b>\$000</b>	<b>\$000</b>	<b>\$000</b>	<b>\$000</b>	<b>\$000</b>
Buildings	13,197	11,362	1,835	731	670	62
Other structures	5,972	1,21	4,850	249	86	162
Roads	103,995	58,941	45,054	3,376	1,852	1,524
Bridges	1010	972	38	27	24	3
Sewerage network	3,539	3,128	411	114	107	8
Other infrastructure	25,872	23,186	2,685	1,150	1,060	90
	<b>153,585</b>	<b>98,711</b>	<b>54,874</b>	<b>5,647</b>	<b>3,798</b>	<b>1,850</b>

The asset classes shown above were revalued using a depreciated replacement cost approach and resulted in an overall increase in the carrying values of \$54.9 million to \$153.6 million. As the gross replacement of these assets have increased, the depreciation charge on the assets will increase. It is estimated that Council's annual depreciation expense will increase by \$1.9 million for 2020/21.

It is noted that the valuations above do not include capital work in progress (e.g. airport pavement resurfacing) of \$40.7 million. Once the capital works are finalised and depreciation commenced, there will be a further increase to Council's annual depreciation expense.

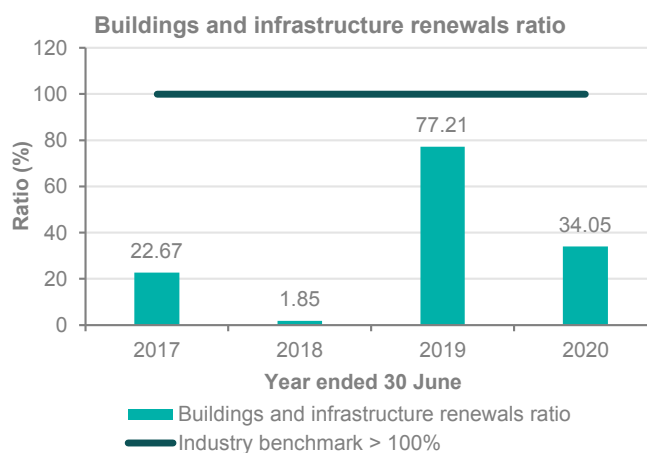
**Buildings and infrastructure renewals**

An important responsibility of Council is the ongoing maintenance and renewal of the community's buildings and infrastructure. Renewal is defined by the International Infrastructure Management Manual as 'works to upgrade, refurbish or replace existing facilities with facilities of equivalent capacity or performance capability'. The performance of Council in this area can be measured using the 'buildings and infrastructure renewals ratio' as depicted in Exhibit 17.

**Exhibit 17: Buildings and infrastructure renewals ratio**

The 'buildings and infrastructure renewals ratio' measures the rate at which these assets are renewed against the rate at which they are depreciating.

An industry benchmark is considered to be 100%, measured annually over the long term.



As can be seen in the graph above, Council has failed to meet the industry benchmark for this ratio during the time of its existence. A lack of attention to asset renewal can result in aging and/or failing

assets. Given the estimated increase in depreciation in the coming years, a greater level of expenditure for asset renewals would be required to achieve the industry benchmark.

It is noted that Council spent approximately \$32.3 million in renewal works as part of airport pavement repair and resurfacing project during 2020 and this has been excluded from the calculation of the ratio for 2020 above as these works were still in progress and not yet subject to depreciation. If this expenditure was included the ratio for 2020 would be 886%.

### Financial gap

To assist in estimating any financial gap in the minimum accepted standard of assets, it is useful to consider the guidance on asset condition ratings in the Integrated Planning and Reporting Manual for local government in NSW and the NSW reporting requirements includes in the Local Government Code of Accounting Practice and Financial Reporting. These encourage the assessment of asset conditions using a scale of '1' to '5' as outlined in Exhibit 18.

#### Exhibit 18: Asset condition ratings

Level	Condition	Description	Remaining useful life
0	New	No work required.	100%
1	Excellent/very good	New or as new condition. Only planned cyclic inspection and routine maintenance required.	85%
2	Good	Good condition with minor defects. Minor routine maintenance along with planned cyclic inspection and maintenance.	65%
3	Satisfactory	Average/fair condition with some significant defects requiring regular maintenance on top of planned cyclic inspections and maintenance.	45%
4	Poor	Poor condition with asset requiring significant renewal/rehabilitation, or higher levels of inspection and substantial maintenance to keep the asset serviceable.	15%
5	Very poor	Very poor condition. Asset physically unsound and/or beyond rehabilitation. Renewal required.	5%

The 2020 external valuation of assets adopted a similar rating system based on the recent inspection of assets. In addition to the '1' to '5' scale, a condition of '0' was used for assets considered brand new. For the depreciable components of assets, the fair value of assets was generally determined using the remaining useful lives that have been included in the table above.

We have used the data from the recent external valuation and the condition scale above to estimate of the cost to bring assets to a satisfactory standard, which is shown in Exhibit 19.

**Exhibit 19: Cost to bring assets to satisfactory standard**

<b>Infrastructure Assets</b>	<b>Estimated cost to bring to satisfactory standard</b>	<b>Net carrying amount</b>	<b>Gross replacement cost (GRC)</b>	<b>Assets in condition as a percentage of gross replacement cost</b>					
				<b>0</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>Asset Class</b>	<b>\$000</b>	<b>\$000</b>	<b>\$000</b>						
Buildings	4,566	13,97	38,561	0%	7%	2%	45%	46%	1%
Other structures	291	5,972	7,679	6%	1%	10%	13%	13%	1%
Roads	1508	103,995	134,836	30%	33%	15%	18%	4%	0%
Bridges	69	1010	1958	0%	7%	40%	39%	14%	0%
Sewerage network	160	3,539	6,088	0%	1%	79%	10%	10%	0%
Other infrastructure	3,687	25,872	52,902	2%	1%	37%	45%	2%	13%
	<b>10,270</b>	<b>153,585</b>	<b>242,024</b>	<b>19%</b>	<b>20%</b>	<b>19%</b>	<b>28%</b>	<b>10%</b>	<b>3%</b>

**Infrastructure backlog ratio**

Estimated cost to bring to satisfactory standard

Net carrying amount

$$\frac{10,270}{153,585} = 7\% \quad \text{Benchmark: Less than 2\%}$$

The above calculation indicates that approximately 13% of Council's buildings and infrastructure assets have been assessed to be in poor or very poor condition and the estimated cost to bring those assets to a satisfactory condition is approximately \$10.3 million. This can also be presented as a percentage of the net carrying amount of the assets in the 'infrastructure renewals ratio'. This indicates that Council's infrastructure backlog is 7% compared to the industry benchmark of less than 2%. Our discussions with management indicated that some parts of Council's infrastructure are aging and/or outdated, particularly in respect to water/sewerage, electricity and telecoms. Our calculations appear to support their belief.

It should be noted that the calculations above are the result of a desktop review based only on data derived from the 2020 external valuation of assets. A more detailed exercise would need to be performed by infrastructure asset experts to establish the true cost to address Council's aging infrastructure and drive future plans. There is a need for ongoing condition assessment and detailed rehabilitation/renewal and maintenance plans in order to develop a long term program.

Council is purchasing a new cloud based asset management program, 'Assetfinda', that will assist in maintaining the asset data required.

**Key findings**

- Current asset management plans do not effectively address accepted minimum requirements in order to aid long term plans for asset rehabilitation/renewal and maintenance.
- An asset management system is not currently in use to maintain the required asset data. However, Council is purchasing a new cloud based asset management program.
- Since Council was formed, its level of expenditure for buildings and infrastructure renewals has never met the industry benchmark.

- The 2020 external revaluation of buildings and infrastructure is expected to increase the depreciation charge for those assets by approximately \$1.85 million, meaning it will become even more challenging to achieve the industry benchmark for asset renewals .
- The estimated cost to bring Council's existing buildings and infrastructure assets to a satisfactory standard is approximately \$10.3 million.
- Based on this cost of \$10.3 million, Council's infrastructure backlog ratio is approximately 7% compared to the industry benchmark of less than 2%.

### **Recommendations**

- Asset Management Plans should be reviewed and updated in accordance with the guidance provided in the Integrated Planning and Reporting Manual for local government in NSW.
- The asset management system that is being purchased should be implemented as soon as practicable and be populated with the most current asset data available including asset specifications, costs, useful lives and conditions determined through the recent revaluation. Going forward, the data in the system should be maintained and updated as necessary.
- A detailed assessment of Council's infrastructure assets should be undertaken to establish an accurate cost to address Council's infrastructure backlog.
- Programs should be developed and costed for asset rehabilitation/renewal and maintenance over both the short and long term to ensure Council can meet industry benchmarks for buildings and infrastructure renewals and infrastructure backlog.

## 6. Ledger Structure

### Background

The Terms of Reference requires consideration of Council's ledger structure and its effectiveness, including the use of work orders.

We have reviewed how the ledgers are structured and interact; and made enquires of stakeholders as to key reporting requirements and whether the structure is appropriate for meeting external, internal and budgeting requirements. We have also considered Council's structure compared to other comparable councils that use the Civica Local Government System to assess the efficiency and effectiveness of Council's ledger structure in meeting its key reporting requirements.

Under Local Government Act 1993(NSW) (NI) and regulations made therefore under, Council has the following reporting obligations:

- Audited financial statements that comply with accounting and reporting requirements of Australian Accounting Standards.
- Annual budget.
- Quarterly budget review. Not later than 2 months after the end of each quarter, the responsible accounting officer of a Council must prepare and submit to the Council a budget review statement that shows, by reference to the estimate of income and expenditure set out in the Council's Revenue Policy included in the Operational Plan for the relevant year, a revised estimate of the income and expenditure for that year. A budget review statement must include or be accompanied by:
  - i. A report as to whether or not the responsible accounting officer believes that the statement indicates that the financial position of the Council is satisfactory, having regard to the original estimate of income and expenditure; and
  - ii. If that position is unsatisfactory, recommendation for remedial action.

Internally, reports are also required for projects and costing analysis by budget managers.

To meet the reporting requirements, data is retrieved from various ledgers and then manually compiled.

### Chart of accounts

Council uses the Civica Authority financial module for its financial transactions. The key features of the module structure include:

- General ledger - this is the central repository for financial data, three segments of information are incorporated into the general ledger to facilitate reporting needs:
  - Master accounts: This is a six digit block. The first two digits represent the fund and the remaining four represent account number; they generally define business units. The common practice that is that recurrent income, recurrent expenditure, non-recurrent income and non-recurrent expenditure are set up for each business unit.
  - Sub accounts: This is a four digit block. They are commonly used for operating income and expenditure and individual sub accounts for non-recurrent projects.
  - Resource accounts: this is a four digit block. Generally each line item in the financial statements is allocated a resource account. Other resource accounts may be created for management reporting purposes.

Council's general ledger account structure is not dissimilar to other comparable councils using the Civica Authority system and appears satisfactory to meet reporting requirements, including statutory annual financial statements, budget, and quarterly budget reports.

- Project ledger - this sits parallel to the general ledger, and tends to be used to gather financial data on projects. This ledger reconciles back to the general ledger, but contains data at a more granular level than the general ledger. The project ledger is supported by work orders, with tasks within each work order.

The common use of the project ledger is to gather information on capital projects and certain operational matters to satisfy entity's reporting requirements. For example, in the local government environment, it is common practice that capital projects are set up within the project ledger through work orders.

### Key findings

The Civica system was implemented for the 2017 financial year and Council's chart of accounts was established. Since then, the chart of accounts has been modified and accounts added by various Chief Financial Officers and finance staff.

- The chart of accounts contains a large number of accounts, with many accounts appearing redundant per below.

	# of accounts	# accounts with nil balances	% of accounts with nil balances
General ledger	1,408	368	26%
Project ledger	45	9	20%
Work orders	82	37	45%
Tasks	36	8	22%

Source:

- General ledger: trial balance used for 2020 annual financial statements
- Project ledger, work order and tasks: work paper for third quarterly budget review

- Extensive data manipulation is required to meet some reporting requirements.

Currently, the system reporting tool has not been properly set up to facilitate reporting. For every report, accountants needed to download data into spreadsheets and manually update to ensure the information is accurate and consistent. As a result, finalising reports can take a vast amount of time.

The compilation process for key reports is outlined below:

Requirement	Source data	Method	Manual input
Annual financial statements	General ledger trial balance at resource level	Each account is manually coded with financial reporting codes, then uploaded into financial reporting templates.	The accounts need to be checked annually for new accounts.
Budget & Quarterly budget Review	General ledger trial balance at resource level. Work order and task balances.	An Excel template is used.  Current balance is retrieved from Civica by SQL link from Excel to Civica, then flowed through into various reports.  Other information (e.g. comparatives) requires manual input.	New accounts need to be manually mapped.  This includes new general ledger accounts, new work orders, and new tasks.  Only current balances can be automatically retrieved through the system and formula. However, there are balances in the reports that need to be manually worked out. Comparatives and other information (budget adjustments) need to be manually transferred from previous reports, or supporting documentation.

- Inconsistency with chart of accounts

Project ledgers (work orders and tasks) have been set up between operations and capital. Capital projects contain capital expenditure that flows into either work in progress accounts, or subsequently capitalised to relevant asset classes. At the end of year, those accounts should be cleared to nil.

- As per the third quarter budget review, out of the 46 work orders with balances, there were 7 capital work orders that flowed into operating expenses (materials and contracts).
- We have identified instances where the same work order and tasks have been split into three accounts: work order 293 (Capital - 2 x Lighters) -task 5700 (Plant Purchase).

Work Order	Task	Resource	Resource description	General ledger	Note per financial statement
293	5700	400	Contractors	2220.500.400	IPPE
293	5700	500	Materials Purchased	2220.500.500	Expenses- Materials and contracts
293	5700	505	Inventory Issued From Store	2220.500.505	IPPE



- From discussions with staff, there appears to be a lack of knowledge of the account structure and a reluctance to use work orders due to the quantity of work orders and tasks. We understand there are transactions that have been posted directly into the general ledger by bypassing work orders, which resulted in difficulties in the reconciliation of work orders to the general ledger and the asset capitalisation process.

## Recommendations

- The use of a system driven financial reporting tool should be investigated to enable accurate real time reporting. Manual processes not only lack efficiency, they also increase risk of human error and reduce the effectiveness of financial data in decision making.

We understand that Council has planned for a Civica system upgrade. As part of the upgrade, Council should investigate whether the upgraded Civica reporting tool (Business Intelligence Solution, or 'BIS') will meet its reporting needs or whether another reporting software option is appropriate.

- The existing chart of accounts should be reviewed and redundant accounts and inconsistencies addressed. As part of this review, management should consider whether the chart of accounts meets their needs and whether a complete restructure would be preferred.
- As the accuracy of source data is heavily reliant upon transaction initiators across various departments of the Council, it is important that they know how the system works and have a clear understanding of which work orders/tasks should be used and in what circumstances. A formal list of work orders/tasks should be established, communicated across the organisation to ensure staff are using them correctly, and the appropriate use of the list of work orders should be monitored. Staff training should be provided on a regular basis.

## 7. Budgeting Process

### Background

The Terms of Reference requires consideration of moving the budgeting process from spreadsheets to a web-based solution.

Our review and discussions with management revealed that the annual budget is prepared using a series of Excel spreadsheets and there is no formal documented process or manual that guides the preparation of the budget. In principal, a bottom up approach was to be applied, however, it appears information is provided by some team leaders/managers in different formats and some information has been developed within the finance department. Historically, information was collated by the Chief Financial Officer into a council-wide budget and then revised by the Executive. We understand there was little feedback provided to team leaders/managers on changes and often the budgets proposed ended up being very different to the final version. As such, the budget process was largely a top down approach, resulting in a lack of ownership and accountability by budget managers. It would appear that budget managers receive limited support and management reporting to assist in managing their budgets. The 2020/21 budget was prepared by a consultant following a similar process. However, data from the previous budget could not be located to use a guide. The first quarterly budget review for 2020/21 is expected to involve a major review of the budget.

### Budget vs actual

Exhibit 20 provides a comparison of original budgets to actual results over the last three years.

#### Exhibit 20: Original budget versus actual 2018-2020

Income Statement	2018 (\$000)			2019 (\$000)			2020 (\$000)		
	Budget	Actual	Variance	Budget	Actual	Variance	Budget	Actual	Variance
<b>Original budget vs Actual</b>									
<b>Revenues before capital items</b>									
Rates & annual charges	1,180	1,691	511	1,200	1,603	403	1,751	1,382	(369)
User charges, fees & other revenues	21,091	18,898	(2,193)	20,164	19,304	(860)	22,417	17,580	(4,837)
Grants & contributions provided for operating purposes	8,241	5,554	(2,687)	5,346	6,902	1,556	7,909	8,395	486
Interest & investment revenue	120	299	179	240	398	158	243	259	16
	<b>30,632</b>	<b>26,442</b>	<b>(4,190)</b>	<b>26,950</b>	<b>28,207</b>	<b>1,257</b>	<b>32,320</b>	<b>27,616</b>	<b>(4,704)</b>
<b>Expenses</b>									
Employee benefits & costs	1,322	9,079	1,243	9,643	10,172	(529)	12,982	11,538	1,444
Materials, contracts & other expenses	13,444	12,492	952	12,482	13,081	(599)	14,544	13,265	1,279
Depreciation & amortisation	4,958	4,847	111	4,814	4,841	(27)	4,844	4,624	220
	<b>28,724</b>	<b>26,418</b>	<b>2,306</b>	<b>26,939</b>	<b>28,094</b>	<b>(1,155)</b>	<b>32,370</b>	<b>29,427</b>	<b>2,943</b>
<b>Surplus (Deficit) before capital items</b>	<b>1,908</b>	<b>24</b>	<b>(1,884)</b>	<b>11</b>	<b>113</b>	<b>102</b>	<b>(50)</b>	<b>(1,811)</b>	<b>(1,761)</b>
Grants & contributions provided for capital purposes	3,075	-	(3,075)	-	13,500	13,500	106	33,833	33,727
<b>Net Surplus (Deficit)</b>	<b>4,983</b>	<b>24</b>	<b>(4,959)</b>	<b>11</b>	<b>13,613</b>	<b>13,602</b>	<b>56</b>	<b>32,022</b>	<b>31,966</b>

The above analysis shows there have been significant variances to original budgets over the last three years. It is accepted that it is often difficult for Council to accurately forecast grant income prior to the start of each financial year and variances in grant income have been largely favourable in recent years. It is also accepted that the COVID-19 pandemic greatly impacted Council's results, particularly revenue figures, for 2019/20 and this could not have been anticipated.

Setting aside the difficulty in forecasting grant receipts and the COVID -19 impact, there is a history of significant variances to original budgets across a number of items; suggesting deficiencies in the budgeting processes of Council.

### **Key findings**

- Spreadsheets are used to prepare the annual budget and there is no formal documented process or manual in place to guide the preparation.
- There appears to be little involvement of budget managers in the budgeting process , resulting in a lack of ownership and accountability to budgets.
- There is a history of significant variances to original budgets.

### **Recommendations**

- The budgeting process should be formally documented and a budget handbook/manual developed that guides the development of the annual budget. Staff training should be provided on the use of the manual and use of the manual monitored.
- Budget managers across the Council should be involved in the budgeting process in order to provide input and confirm the veracity of assumptions applied.
- Budget managers should be provided with progressive management reporting and training to assist them in monitoring and managing their budget responsibilities.
- Consideration should be given to implementing a system or web-based solutions to better manage the budgeting and monitoring processes.

## 8. Local Government System and Processes

### Background

The Terms of Reference requires consideration of possible improvements to the Civica Local Government System and the use of the following modules to optimise the efficiency of the Council's operations, being the Plant Asset system, the distribution of overheads, Stores system, Procurement (including Online Ordering and Purchase Cards), Operation of external trust accounts held by Council, Payroll System, and Asset Management.

We have reviewed of the use of the Civica Authority System and the processes implemented by Council. This included a review of the modules included under the contract with Civica and whether they are being fully utilised, and the processes and controls in place to operate the system.

### Civica system utilisation

In reviewing Council's contract with its system provider, Civica, it was noted that Council has access to Authority Best Practice which includes all of the main modules and sub systems of the software. The following modules are included in the contract but appear to be under-utilised:

- Financial System as follows:
  - In the Payroll module, the Timesheets and Leave sub systems are under-utilised, discussed below in the payroll section.
- Asset Management module, specifically the following sub modules:
  - Asset Accounting – see below for detail
  - Fleet Maintenance – used but in a limited manner, see below for detail
  - Inspection Management – not currently utilised
  - Strategic Asset Management – not currently utilised
  - Mobile Assets – not currently utilised.
- Document Manager
  - HP RM8 Records Management – see below for detail.
- Reporting Modules
  - Business Intelligence – not currently utilised
  - Excel Reporting Wizard – not currently utilised.
- Corporate Performance Management
  - Performance Manager – not currently utilised
  - InfoCouncil – utilised monthly by the executive and management team to prepare Council and committee papers.

The document management system is not fully utilised, with a large amount of Council records only kept in hard copy and the remaining space for storage is minimal. There are risks of manipulation of hard copies of documents, as well as misplacing documents with no backups. The filing of hard copies is also labour intensive, which could be minimised by scanning original documents and using the soft copy document management system.

It would be beneficial for Council to review whether there are efficiencies that can be gained from utilising some of the under-utilised modules and whether there are opportunities for cost savings in respect to items not required.

### Procurement and accounts payable

Our review of the procurement system and processes noted the following controls in place:

- There is a comprehensive Procurement Policy.
- Council has approved limits for procurement depending levels of authority.
- Delegations of authority have been implemented within Authority, meaning there is a system control to ensure purchases are made within the requisitioning officer's limit.

- Invoices are matched to purchase orders when received, with the requisitioning officer signing off the invoice to confirm correct receipt of goods and services.
- Appropriate procedures for raising and approving payments.
- The supplier master-file is reviewed independently on a regular basis.

It was noted that the procurement process was being implemented per the approved policy. However, we were alerted to an issue where purchase orders were sometimes raised subsequent to receiving invoices for goods and services. Although the Authority system requires the user to raise a purchase order prior to inputting an invoice, this can be bypassed by raising a purchase order when receiving an invoice and inputting both on the same day. We noted that there were multiple invoices which had the same date as the matched purchase order, which demonstrated this. Without a purchase order being raised in the system, management will not be able to accurately estimate the value of future expenditure committed by Council at any given date.

## **Payroll**

The payroll function at Council is well set up, within the Human Resources (HR) department, and consists of five employees. Three staff members are able to access the payroll module, being the Human Resources Manager, Senior Human Resources/Payroll Officer and the Human Resources/Payroll Officer. It was noted that there were generally thorough processes and adequate controls in place, including the following:

- Those responsible for hiring are independent of payroll, with segregation of duties throughout the process.
- I.T. have to initially set up new employees in the system prior to HR completing their pay details.
- Timesheets are signed by the employee and then authorised by the employee's supervisor before being entered into the system.
- Termination calculations are independently reviewed before being paid through payroll, with significant terminations being reviewed by the General Manager.
- Pay runs are independently reviewed before being authorised for payment.
- Payment of payroll requires two authorisers within the online banking system, one of which is independent of the HR/Payroll function.

During the review of the payroll system, it was noted that timesheets are completed using Excel spreadsheets, before being signed off by both the employee and their supervisor. This is a strong control, with a second tab for employees who are required to allocate their time to multiple work orders, ensuring costs are posted to the correct expense ledger. However, once payroll receive the completed timesheets, they are entered into Authority manually, with overtime and hours not relating to normal pay also being calculated manually. This is labour intensive, particularly for those whose timesheets are standard, and manual input is subject to human error, potentially leading to employees being under or over paid.

Due to the issues payroll have had with leave balances since the implementation of Authority, these have been recorded and maintained in an Excel based register, with Authority being updated manually as and when required. This has meant employees have been unable to readily access their balances and project their balances in order to plan leave. This has also created a greater work load on the payroll team, having to manually keep track of leave accruals, leave taken and calculations for terminations. Civica were able to correct the leave balances within the Authority system during the financial year ended 30 June 2020, however, this was prior to a new Employee Agreement being approved which entitles employees to six weeks leave rather than four weeks. Per advice from Civica, this has not yet been updated in the system as it is likely to create potential errors if the script is introduced before the 2019/20 year is closed. As such, payroll has continued to maintain the Excel spreadsheet to track annual leave balances.

The payroll master-file report, which is an audit report showing changes to an employee's details (bank details, pay rate, hours, etc.) is not produced and independently reviewed. This creates an opportunity for a member of the team to fraudulently change the details in the system for a pay run before reverting them back to the correct details.

## Receipting and accounts receivable

The receipting module in Civica Authority has been set up so that when amounts are receipted, the cashier uses a receipt code for the type of receipt, which is linked to a specific general ledger and is automatically posted to the correct revenue stream. The revenue streams include:

- Rates
- Registration sales (firearms, driving licences, etc.)
- Library payments
- Mobile software and Mobile top-up software
- Car registration
- Weighbridge charges
- Animal registration.

Some revenue streams are accounted for in separate systems and manually entered into Authority, including the following:

- Museum sales (books, tours, entry fees) consist of EFTPOS or cash which is deposited the next day. A manual journal is posted into Authority to recognise this.
- Airport sales (landing fees) are EFTPOS only with a receipt list provided to finance to enter as a journal into Authority, with airport staff being responsible for tracking landing of flights and subsequent invoicing. Monthly statements are sent to customers.
- Liquor Bond Retail sales are recoded in Retail Systems Australia Point of Sale (RSAPOS) software, receiving both EFTPOS and cash (deposited next day). A manual journal is processed by finance to recognise revenue in the system.
- Tourist Bureau sales (books, tours, etc.) are recorded in separate software called Bookeasy, with a manual journal posted by finance into Authority.
- Telecom (PSTN/ADSL) and electricity sales are processed in Telstream, an external software solution, with a manual journal posted by finance into Authority.

Although the above revenue streams invoice externally from Authority, all amounts are receipted into the Council's bank account, therefore the bank reconciliation is an additional control to ensure that amounts are receipted correctly. This does, however, rely heavily on the bank reconciliation being properly performed.

All systems appear to be set up correctly and processes are adequate, however, there is a lack of segregation of duties throughout. The lack of segregation includes processes such as:

- Receiving and depositing cash
- Receipting amounts and reconciling end of day reports with no independent review
- Employees responsible for the complete debtor cycle of certain revenue streams.

A lack of segregation of duties, particularly around cash, creates an opportunity for fraud. Other noticeable control deficiencies included:

- Daily reconciliations including cancelled receipts are not independently reviewed
- There is no official signoff process on a daily basis
- Banking slips are not used to deposit cash, however, a deposit slip is obtained from the bank
- Monthly reconciliations are not completed between external unintegrated system reports and general ledger balances.

The rates module, which the rate levy calculation relies upon has adequate controls and processes surrounding the input of data and updating of rates and land values. Annual notices are issued in July, with three instalments notices issued throughout the year.

Monthly statements are sent for outstanding debts for other key revenue streams. For revenue streams which provide a service, for example Telecoms, if payment is not made by the 22<sup>nd</sup> day of the following month, services are disconnected.

## Bank reconciliations

As mentioned above, the bank reconciliation is heavily relied upon as a control for a number of processes, which increases the importance of accuracy of the reconciliation. It has been noted that when the details of transactions are unknown during the bank reconciliation, 'other' general ledger accounts have been used to ensure that the reconciliation balances.

## Asset management

Asset management is a key function of Council, which can be split into the areas of asset accounting and asset management.

The accounting treatment of assets will focus on the process behind capitalising costs and subsequent accounting entries to record other movements. Delegated officers set up work orders for each capital project to keep track of expenditure allocated to these projects, coming from either the Plant, Payroll or Procurement systems. As the Council is relatively small, these projects are infrequent and therefore straightforward to manage, project balances are monitored as they incur costs, however, there is no written policy documenting this. Upon completion, the expenditure is reviewed prior to being capitalised to the Asset Accounting sub system. This process and control ensures that all amounts that relate to capital expenditure and are allocated to the correct asset class. However, the weakness in the system is that assets are not monitored through here, instead they are transferred to a fixed asset register maintained in an Excel spreadsheet.

Using a spreadsheet as an asset register is not only labour intensive, it is also prone to error and formula mistakes which could lead to misstatements. There is also a risk of the asset accounting system not being kept up to date and the Council unable to precisely keep track of asset written down values and disposals. Depreciation is calculated in the spreadsheet and entered into the accounting system via a manual journal. Again, this is labour intensive and prone to error. Management has recently identified errors in the calculation of depreciation, including approximately \$170,000 of depreciation being recognised in 2019/20 for assets which no longer existed.

Council does not currently utilise the Strategic Asset Management module within Civica. However, Council is purchasing a new cloud based asset management program, Assetfinda, to maintain asset data.

## Plant system/fleet maintenance

The fleet maintenance system in Authority is available for the Council to track the use and maintenance costs associated with its fleet. Employees are able to record in their Excel timesheets details of the plant number and hours used, which is subsequently entered into Civica during the payroll process and allocated to specific jobs. It was noted that only some employees complete this task on a regular basis, with other employees who used plant, not including any data on their timesheets. Maintenance costs associated with plant assets appear to be kept track of manually, without the use of the system, which creates additional administrative work for staff. We understand the Fleet Manager was made redundant in June 2020 and it appears the system has not been used since then.

## Inventory and stores

We reviewed the process and system for controlling inventory held by Council, which generally includes electrical, mechanical, telecommunications, cleaning, protective equipment, dangerous goods, hardware and stationary products. The following processes were noted:

- Annual stocktake with periodic cyclical counts throughout the year. Discrepancies are rarely identified, but when they are, the items are noted, investigated, and filed for reference.
- Inventory is re-ordered per the Procurement Policy, with the same delegation limits applied.

- Sales of inventory are recorded directly in the system, ensuring accurate record keeping. Inventory is generally used by the Council or sold to private retailers. There are no sales to the general public.
- Inventory used by the Council is requisitioned, with the request put through the work order detailing employee name and number for which a docket is printed and signed by the requisitioning officer. These dockets are filed in chronological order.
- Searching in the stock issue enquiry in Authority by employee number or work order will show all inventory signed out by that employee including date, time and other information.
- If inventory is returned, the docket is updated which will match Authority, completing the cycle.

Raw materials, in particular road materials, were enquired about, however, due to the small number of roads and infrequent repairs the depot keeps very limited supplies, if any, and procures them as and when required.

The main shortcoming of the inventory system is the lack of a low stock identifier to aid in determining when to re-order certain inventory items. Council has not been able to create a re-ordering report which correctly identifies low stock levels, therefore, stock is often ordered too late to replenish items that run out. This leads to inefficiencies in sales due to the long lead times in obtaining inventory, which has to be air freighted from the mainland, and short-term purchasing resulting in additional costs.

### **Distribution of overheads**

The distribution of overheads is essential for Council to effectively budget costs and for accurate management reporting. Previously, a percentage was determined and applied against certain expense types for each cost centre to arrive at that cost centre's monthly overheads. Currently the methodology behind these percentages is unknown, with a new methodology yet to be determined.

### **Trust accounts**

Council manages the following key trust accounts:

- Curator of Deceased Estates
  - These monies are maintained in a separate bank account, however, all estates are processed through the same account instead of individual accounts for each trust.
  - Supporting documentation is kept and passed onto the recipients of each estate as funds are disbursed and received.
  - A formal reconciliation is kept externally of the accounting system of all movements in each deceased estate.
  - A reconciliation to the general ledger, showing the balance of each estate is not maintained and reviewed.
- Legal Aid Trust Fund
  - The trust is managed in a separate bank account.
- Other Trust Accounts
  - All other trusts amounts are held within Council's operating bank account, including Iven 'Toon' Buffet Environment Fund, Protecting National Historic Sites and Norfolk Island Language Trust.
  - A detailed reconciliation of trusts and their movements has not been maintained and was not readily available, however, transactions are very infrequent.

Management recently identified an issue where an amount was transferred out of the Curator of Deceased Estates bank account to Council's operating bank account in June 2019 and no explanation was clearly documented. The amount has been subsequently returned to the Curator of Deceased Estates bank account.



## Workers Compensation Scheme

Council is responsible for the administration of the Norfolk Island Workers Compensation Scheme (the Scheme) through its Service Delivery Agreement with the Commonwealth. In June 2020, Council engaged a contractor to review Council's accounting for the Scheme. He reported that the Scheme was being operated within one set of accounts in Council's ledger structure but two bank accounts are being used; the Scheme bank account plus Council's general operating account. He noted that this arrangement was causing confusion and made it difficult to reconcile the true position of the Scheme.

We understand the Scheme is to be removed from Council's system into an external online accounting system pending handover of the administration to a third party provider. This should address the issues noted and ensure that Scheme transactions no longer go through Council's operating bank account.

## Key findings

From our review of Council's use of the Civica Authority System and the related processes, it appears that Council generally has reasonable controls and processes in place across the major transaction cycles, however, the following matters were noted :

- Modules included in Council's contract with Civica that are not being utilised or are under-utilised.
- Procurement process of raising purchase orders prior to obtaining goods or services is sometimes being bypassed.
- Labour intensive manual input and calculation of timesheets and leave accruals.
- The payroll master-file report is not produced and independently reviewed.
- Lack of segregation of duties and controls surrounding receipting.
- Inaccuracy of bank reconciliation .
- Fixed Asset Register is maintained in an Excel spreadsheet.
- Depreciation was being calculated on assets which no longer exist.
- Inefficiencies surrounding the re-ordering of inventory.
- The fleet maintenance system is under-utilised.
- Lack of a documented process for the distribution of overheads.
- Detailed reconciliations of movements in trust accounts are not maintained.
- Workers Compensation Scheme transactions processed through Council's operating bank account.

It was noted during the review that there appears to be a lack of staff training across the organisation. Our discussions with management indicated high staff turnover over the last four years. Accordingly, the training which occurred during the implementation of Authority would have been for staff no longer working for the Council. This has meant a loss of corporate and system knowledge.

## Recommendations

### • **Civica system utilisation**

Council should review whether there are efficiencies that can be gained from utilising some of the under-utilised modules and whether there are opportunities for cost savings in respect to items not required. Council should ensure that the Civica modules used and any software purchased separate to Civica are fit for purpose. For any software independent of Civica, the compatibility with Civica should be ensured in order to reduce manual manipulation of data and increase efficiencies.

To reduce labour intensive activities, consideration should be given to fully utilising the Document Management System. This would not only save time when searching for documents, but also the ability to link a document to a transaction or entry would provide easy access when reviewing entries.

### • **Procurement**

Regarding the procurement process, it is recommend that staff be trained on the importance of raising purchase orders before expenditure is incurred with suppliers. This control should be enforced by management and will enable them to accurately report future expenditure and manage cash flow.

### • **Payroll**

The payroll function has a number of labour intensive activities, which also have a high risk of error due to a significant amount of manual input, including timesheets and leave accruals. Consideration should be given to utilising the system or appropriate add-ons to automate those processes, including the following:

- Completion of timesheets with appropriate authorisation levels;
- Linking of timesheets to pay runs;
- Automated timesheets for those administrative employees that are not required to allocate their time to jobs;
- Calculation of overtime hours, allowances and other payroll related values;
- Calculation of all leave accruals;
- Reduction in leave balances for leave taken, linked to timesheets; and
- Reporting of current leave balances on payslips so employees can accurately project their leave entitlements for future planning.

It is also recommended that Council implement an additional detective control, being the independent review of the payroll master-file after each pay run. This will reduce the risk of errors through mistakes or fraudulent activity.

### • **Receipting**

Whilst acknowledging segregation of duties can be difficult to achieve with a small team, it is desirable to limit an employee's involvement in all aspects of the receipting cycle. Additional controls to reduce risk should be considered including:

- Independent review of end of day reconciliations;
- Independent employee responsible for banking cash using banking slips which can be matched to deposit slips obtained from the bank;
- Detailed bank reconciliations performed by an employee independent of the receipting system; and
- Monthly reconciliations of external unintegrated systems to the general ledger.

### • **Bank reconciliation**

The issues identified surrounding the bank reconciliation appear to relate to a lack of appropriate training provided to Council staff, likely due to the high turnover in recent times. Council should identify all unknown differences in the bank reconciliation and investigate these items to ensure postings are

accurate and allocated correctly. Going forward, employees responsible for the bank reconciliation should be provided with any necessary training in the bank reconciliation process. The reconciliations should be reviewed on a regular basis by an officer independent of the preparer.

- **Asset management**

Consideration should be given to utilising the Asset Accounting system available in Civica Authority, or an alternative, and upload an up to date, complete fixed asset register into the system. Prior to uploading, the Council should complete a comprehensive cleanup of the fixed asset register spreadsheet, confirming asset values, useful lives and the completeness of the register, including disposing of assets that no longer exist.

Although it would be a significant project to ensure the fixed asset register is complete and accurate, once it is set up correctly, the utilisation of the system would save time in accounting for assets. This would also reduce the likelihood of misstatement through error in calculations or posting of journals, improving the accuracy of asset reporting.

- **Plant system/fleet maintenance**

Consideration should be given to utilising the fleet maintenance sub system, ensuring all plant is correctly recorded in the system before enforcing a process for employees to record use and maintenance of the fleet. This would enable Council to allocate the use of plant across work orders and to keep track of maintenance incurred on each asset, aiding with planning for renewing the fleet and managing maintenance schedules.

- **Inventory**

The inefficiencies created by a lack of timely re-ordering of inventory can be addressed by creating a report showing low stock levels and identifying when items need to be ordered.

- **Allocation of overheads**

Council should determine an appropriate method for allocating overheads. Workings behind these allocations should be kept as an audit trail so that knowledge is not lost going forward. The resultant rates can be updated in the system so that expenditure can be systematically allocated across cost centres.

- **Trust accounts**

All trust accounts should be reconciled on a monthly basis, showing all movements and be reviewed by an officer independent of the preparer, irrespective of whether the trust monies are kept in a separate bank account or within the Council's bank account. This will not only help Council keep track of the amounts held in the trust, but will ensure a monthly review of movements is being completed, reducing the risk of misstatement and erroneous payments from trust monies.

- **Training**

The Civica Authority system can only be used to its potential if staff fully understand how the system works and how their designated tasks are meant to be performed within the system. Consideration should be given to investing in training in the use of the system and related processes and procedures to assist staff in performing their roles in the most effective and efficient manner. The training should be ongoing and accompanied by ongoing support.

- **Workers Compensation Scheme**

Council should fully reconcile and determine the financial position of the scheme before the administration of it is handed over to a third party provider.



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