

Financial Sustainability Review

Key Findings



AEC Group (AEC) was engaged by Upper Lachlan Shire Council (Council) to undertake a Financial Sustainability Review with the purpose for Council to better understand the current financial position of the Council and to consider options for improving the short and long term financial sustainability of the Council.

On the 20th October 2023, AEC presented to the Council the key findings of the assessment and outlined options for the Council to consider to improve the concerns raised in the key findings.

The following is a summary of the key findings shared with the Upper Lachlan community to better inform the community members and to enable the Council to engage with the community in considering the options available.

Assessment of the historical financial performance

Council has produced a consolidated net operating deficit (excluding capital grants) for the 2020/21 and 2021/22 financial years, with budgeted deficits to be produced for 2022/23 and 2023/24 – see Table 1 below – and note that the financial statements for 2022/23 were not available for this report therefore the adopted budget is stated. Council is required to manage the water and sewer services as a separate fund type, therefore the consolidated position includes the Water Fund, Sewer Fund and General Fund (all other services).

The operating deficit is not due to water, sewer or waste services, but rather other services and infrastructure within the General Fund – see Table 2 below for the General Fund Income Statement. The revenue sources of the General Fund is predominantly funded by the general rate revenue, fees for services and operating grants.

Table 1 – Consolidated Income Statement

INCOME STATEMENT – CONSOLIDATED	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
	ACTUAL					BUDGET	
Income from continuing operations							
Rates and annual charges	10,195	10,580	11,028	11,479	12,221	12,863	13,652
User charges and fees	7,509	8,037	5,155	6,544	6,055	6,311	6,359
Other revenue	597	948	1,622	1,367	775	717	675
Grants and contributions provided for operating purposes	8,648	8,777	10,036	10,263	12,924	9,550	11,047
Grants and contributions provided for capital purposes	6,082	2,993	6,319	7,336	11,484	20,113	13,426
Interest and investment revenue	731	772	512	289	127	322	1,258
Other income	-	-	-	-	-	-	-
Net gains from the disposal of assets	16	-	-	-	336	10	229
Internal Revenue	-	-	-	-	-	-	-
Total income from continuing operations	33,778	32,107	34,672	37,278	43,922	49,886	46,646
Expenses from continuing operations							
Employee benefits and on-costs	9,943	11,105	11,123	11,847	12,708	12,383	14,153
Materials and services	7,339	7,930	7,084	12,564	11,683	9,903	13,051
Borrowing costs	172	223	177	282	49	257	279
Depreciation, amortisation and impairment of non-financial assets	6,086	6,682	6,766	7,223	8,522	8,451	8,994
Other expenses	2,675	2,759	2,757	617	639	617	890
Internal expenditure	-	-	-	-	-	-	-
Net losses from the disposal of assets	51	202	89	1,299	-	240	104
Total expenses from continuing operations	26,266	28,901	27,996	33,832	33,601	31,851	37,471
Operating result from continuing operations	7,512	3,206	6,676	3,446	10,321	18,035	9,175
Net operating result for the year before grants and contributions provided for capital purposes	1,430	213	357	(3,890)	(1,163)	(2,078)	(4,251)

The operating deficits in the General Fund are not expected to be rectified without action to correct the net operating position – either through increasing the income or decreasing the expenses. A key expense item which has increased is depreciation, which has increased due to new and upgraded assets, as well as a general increase in the valuation of assets. Depreciation can not be reduced (not without disposing of assets) and the increase in depreciation indicates that the Council needs to plan for more costs in maintaining and renewing assets into the future.

The key issue with producing operating deficits is that the Council is not able to produce sufficient cash to deliver the current services and producing enough surplus cash from operations to invest in the maintenance and renewal of public infrastructure and other assets necessary to provide the services. With operating deficits it is likely asset condition and performance will deteriorate, increasing the risk related to the failure of the asset or the performance of the asset.

Table 2 – General Fund Income Statement

INCOME STATEMENT – GENERAL	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
	ACTUAL					BUDGET	
Income from continuing operations							
Rates and annual charges	8,254	8,624	8,931	9,290	9,875	10,395	10,985
User charges and fees	6,253	6,735	3,730	5,222	4,626	4,868	4,906
Other revenue	590	948	1,622	850	664	717	675
Grants and contributions provided for operating purposes	8,630	8,743	10,000	10,227	12,888	9,510	11,047
Grants and contributions provided for capital purposes	4,531	2,841	6,107	7,305	10,912	19,137	12,527
Interest and investment revenue	564	583	391	251	94	184	761
Other income	-	-	-	-	-	-	-
Net gains from the disposal of assets	-	-	-	288	341	-	140
Internal Revenue	-	-	-	-	-	-	-
Total income from continuing operations	28,822	28,474	30,781	33,433	39,400	44,811	41,041
Expenses from continuing operations							
Employee benefits and on-costs	9,162	10,149	10,095	10,550	11,575	11,138	12,841
Materials and services	6,380	6,882	5,954	10,507	9,920	8,319	11,313
Borrowing costs	102	161	123	236	12	220	249
Depreciation, amortisation and impairment of non-financial assets	5,067	5,631	5,780	6,214	7,406	7,421	7,938
Other expenses	2,308	2,416	2,367	612	626	617	849
Internal expenditure	-	-	-	-	-	-	-
Net losses from the disposal of assets	51	204	89	1,623	-	190	104
Total expenses from continuing operations	23,070	25,443	24,408	29,742	29,539	27,905	33,294
Operating result from continuing operations	5,752	3,031	6,373	3,691	9,861	16,906	7,747
Net operating result for the year before grants and contributions provided for capital purposes	1,221	190	266	(3,614)	(1,051)	(2,231)	(4,780)

Assessment of the availability of cash

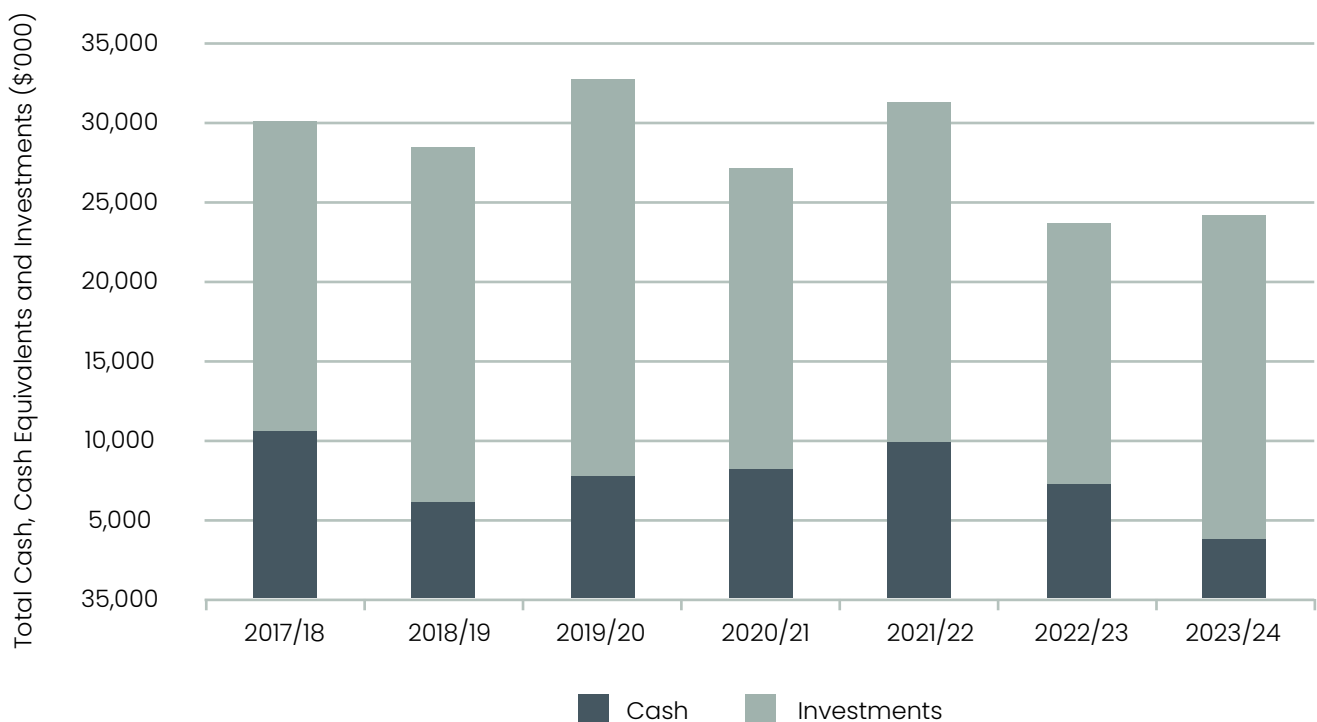
While the Council completed the 2021/22 financial year with in excess of \$31.3million in total cash and investments, the Council is anticipating a deteriorated cash position by the end of 2023/24 to a total of \$24.1million – see Figure 1. Furthermore, the cash that Council holds at end of year must be restricted for quarantined purposes. Cash for external restrictions as at the end of the 2021/22 financial year was \$22.2M of the total 31.3million in cash and investments held by Council. External restrictions include developer contributions, water and sewer funds (that can not be used for any other purpose) and grant funding that is yet to be spent on the purpose the grant was provided for.

In addition to external restrictions, Council must internally restrict cash for other commitments, such as employee leave entitlements, rehabilitation of gravel pits and landfill and prepayment of operating grants. The total of internal restrictions at the end of the 2021/22 financial year was \$9.0million.

At the end of the 2021/22 financial year, after accounting for internal and external restrictions, there was only \$0.028million remaining in unrestricted cash. Unrestricted cash is important, as it is a key financial mitigation for unplanned events. However, when the cash position of Council was reviewed historically, it was also identified that the balances in the internal restrictions has been decreasing since 2017/18. That is, Council has not been producing sufficient cash since 2017/18 to maintain the restrictions, with progressive “draining” of the reserves. This has resulted in no cash in the reserves for building and infrastructure improvements, gravel pit restoration, land fill remediation, plant and vehicle replacement and state road works contingencies.

The cash position of Council is considered to be a major concern, with a deterioration in recent years resulting in lack of cash to fund necessary reserves. This is a major risk and required urgent attention.

Figure 1 – Total Cash and Investments at End of Financial Year – Consolidated Funds



Historical Investment in Assets

A review of the historical investment in assets has identified that while Council has spent \$73.3million over the past five years on capital expenditure, at an average of \$14.7million per year, The expenditure on renewal of assets is insufficient to match the rate of consumption (or depreciation) in the assets.

At the end of the 2021/22 financial year the council reported in the Report on Infrastructure Assets (a Schedule attached to the financial statements) an estimate of \$17.9million required to be spent on asset to bring the assets back to satisfactory standard. Furthermore, in the same report the Council reported significant percentage of assets in a poor or very poor state for buildings, stormwater and other space/recreational assets.

Upon further investigation into the current investment in the renewal of assets, AEC concluded that the Council required at least an additional annual investment of \$2million in the renewal of assets.

Independent Forecast of Council's Financial Position

The operating deficit in the General Fund has deteriorated in recent years to an AEC estimate of approximately \$4.9 million as at end of 2023/24 – after separating waste into a separate fund – this could be considered as a “structural deficit” due to being recurrent in nature. This structural deficit in the General Fund is forecast to maintain steadily around an average of \$4.4 million deficit over the forecast period from 2024/25 to 2033/34.

While the consolidated position of Council shows sufficient cash being generated and total cash and investments remain steady from \$30.0 million to \$30.3 million across the 2024/25 to 2033/34 financial years, this is a result of cash surpluses generated in the Water Fund and Sewer Fund offset by a cash decline in the General Fund. General Fund cash is deteriorating from \$18.5 million in 2022/23 to negative position in 2033/34.

Deterioration of the cash position to an untenable position is despite an insufficient investment in renewal of assets that will also likely result in a general deterioration of assets and continue to increase the backlog in renewals. The Council requires an urgent correction to the generation of cash from operations in the General Fund to maintain adequate cash reserves and to invest sufficient funds in the renewal and maintenance of the existing assets.

Options Available

The Council has the following options available to correct the cash being generated from operations in the General Fund.

While a combination of the options is recommended, any combination will require an increase in the ordinary rates through a special rate variation, and will require a substantial increase in the 2024/25 financial year to address the urgency of correcting the cash position of the Council.

1. Increasing ordinary rates through a special rate variation beginning in the 2024/25.

Impact – if approved by IPART will result in a certain and immediate recurrent correction, greatest potential in terms of size of correction, places additional cost burden on ratepayers, requires substantial community engagement, cost to prepare and submit application to IPART as well as ongoing reporting requirements.

2. Increase fees and charges on services (to achieve full cost recovery)

Impact – certain and immediate recurrent correction, limited potential in terms of size of correction, may impact on demand for Council services, places additional cost burden on ratepayers.

3. Realise operational efficiencies and productivity improvements

Impact – less certain, realised over time, recurrent correction, limited potential in terms of size of correction, may require initial investment to achieve outcome, cost of service reviews, requires multi-year commitment to achieve, may involve shared arrangements.

4. Reduce Range and/or Levels of Service

Impact – Certain, realised over time, recurrent correction, cost of service reviews, limited potential in terms of size of correction, political/reputational risk due to reduced service provision, requires multi-year commitment to achieve.

5. Sale of Surplus Assets to Reduce Debt Burden

Impact – Somewhat certain, realised over time, correction over life of debt, cost of asset sale, political/reputational risk, limited potential in terms of size of correction.

6. Rationalisation of assets (dispose of assets, multiuse facilities)

Impact – Somewhat certain, realised over time, cost of asset sale, political/reputational risk, limited potential in terms of size of correction.