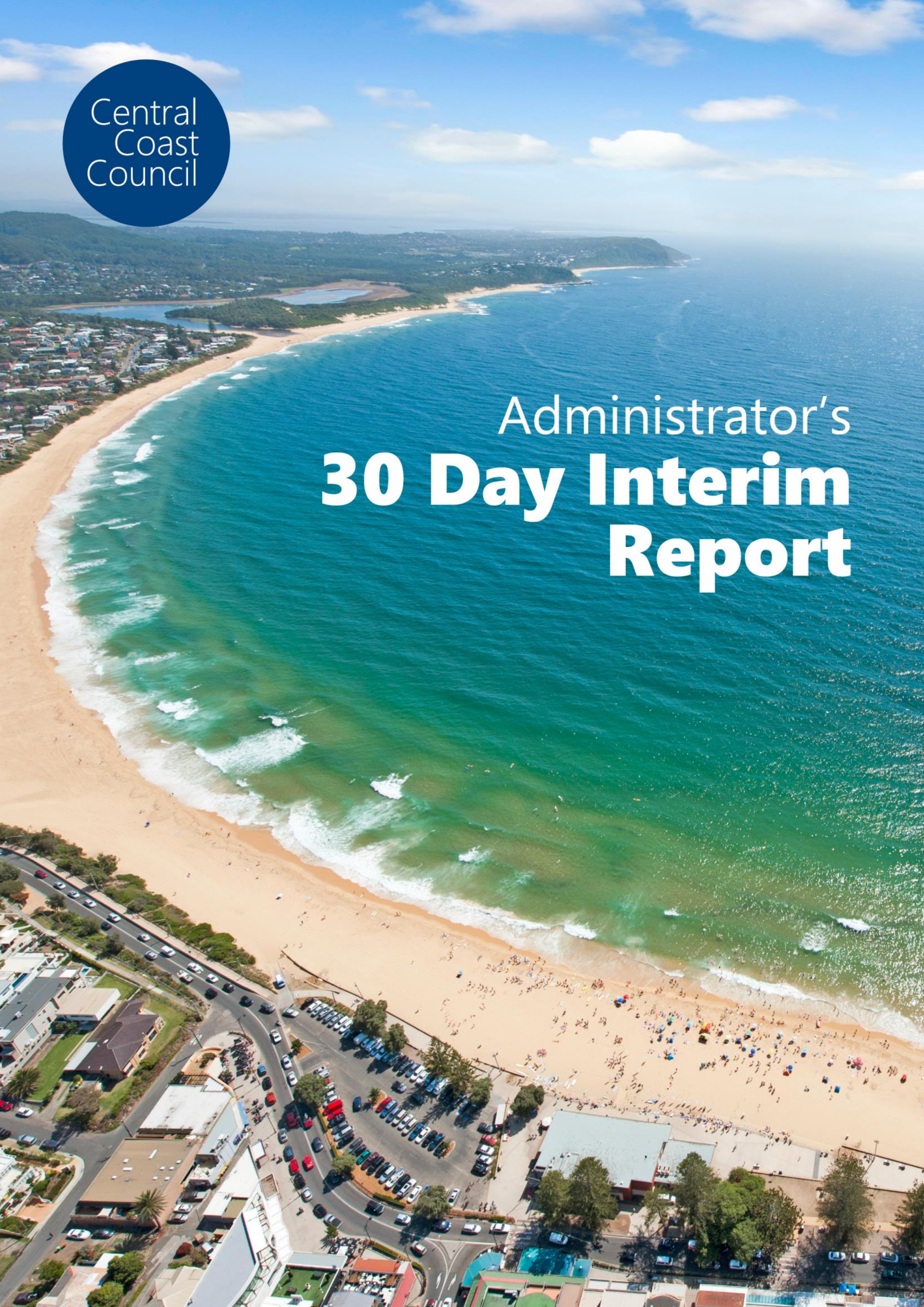
Central Coast Council

Administrator's 30 Day Interim Report



Introduction

This report to the community of the Central Coast Council [CCC] sets out my preliminary findings and conclusions about how Australia's 6th largest council found itself moving from a $65.4m surplus financial position at the time of amalgamation in 2016/17, to a substantial financial loss in each of the three years since, and to a position where it needed a State Government 'bail-out' to pay its staff and creditors.

The report attempts to answer some of the questions raised by ratepayers and residents about how this happened and who was responsible. It identifies options available to move the CCC from where we are now, to where we need to get to if our unsustainable losses are to be turned around, our debt repaid and services and community projects are once again able to meet reasonable community expectations.

CCC residents have been badly let down by their Council and widespread anger over the Council's performance is totally understandable.

Executive Summary

- The financial crisis confronting the CCC is very serious. It will take urgent and strong action to turn things around.
- The Council's operating loss for the current financial year is forecast to be in the order of $115m. This follows last year's loss of $89m.
- At the end of this financial year accumulated losses over the past 4 years will be over $200m.
- Accumulated debt [including funds required to be repaid to CCC Restricted Reserves] will be in the order of $565m.
- There are no easy measures that would enable the CCC to get back into the black, and to then achieve the surpluses necessary to allow debt to be repaid.
- This is a story about the failure of a Council to understand or practise the basics of sound financial management.
- The investigation has found NO evidence of theft or corruption.
- The newly amalgamated Council clearly did not understand how much money they had at the outset. They set about a program of expanded capital works and expanded services that they could not afford.
- Apart from budget mismanagement, Council funded much of this new expenditure from Restricted Reserves, which was either unlawful, or done without the approval of the elected body.
- The previous CFO, Mr Craig Norman and CEO, Mr Gary Murphy were aware of this unlawful use of funds. While the exact time they became aware remains hard to ascertain, emails and notes indicate they continued to spend funds unlawfully after they became aware and before they advised the elected body.

- Councillors should not be expected to have identified the unlawful and unauthorised use of Restricted Reserves, particularly given they were not identified in reports to Council by the then CFO and the CEO, nor were they identified in the NSW Auditor General's audit for the last three financial years.
- The Council's rapid financial decline is in part due to several matters, with only the IT costs directly related to the amalgamation:

  1. The substantial costs in upgrading IT systems and infrastructure [net of $10m Government grant] is $50m, with $8m ongoing.
  2. The substantial costs of an industrial dispute concerning 38/35 hour week, unified salary scale and other harmonisation costs [$25.3m, with $3.2m on-going].
  3. The $39m loss of revenue (compared to 2018/19) from the 2019 IPART pricing determination for water, sewerage, stormwater drainage and trade waste services.
  4. The increased costs and revenue losses brought about by the bushfires, floods and COVID-19 are estimated at $10.5m.
- This very substantial sum of new costs seems to have been overlooked by the new Council as it embarked on major spending programs in both capital works and general operations.
- In 2019/20 the Council embarked upon a $242m capital works program which is $69m more than the average capital spend over the previous two financial years based on the incorrect assumption the capital works program could be paid for from Restricted Reserves. They agreed to another $224m program this financial year. Mr Hart, Council's Acting CEO will reduce this to $172m.
- A number of these projects exceeded their budget – for example the Water Fund exceeded its capital budget allocation for 2019/20 financial year by $12m, while the Sewer Fund exceeded by $2.6m and Drainage Fund exceeded by $1.2m.
- There is no evidence that either the elected body or senior management gave a priority to achieving savings possible from the merger. To the contrary, Council embarked on a number of expansive initiatives, some with highly paid staff that resulted in employee costs significantly outstripping projected revenue growth.
- There are around 250 more people (FTE) employed now than at the time of the amalgamation.
- Budget/financial management is the singular most important task of the Council, which is made up of both the elected body and the CEO and senior management.
- While there are several mitigating circumstances [outlined above] which may explain how the 2019/20 budget 'got away' from CCC, with a $89m operational loss, there is no reasonable excuse for this current year's budget overrun which is now forecast to blow out to $115m.
- If the tough measures outlined later in this report were taken in March - April last financial year [when that year's losses became clear], Council could now be between $50-$100 million better off.
- The CEO is the 'accountable officer', with overall responsibility for financial management. Required performance was not met.
- The CFO is the responsible accounting officer and likewise his performance did not meet the required professional standards.

- Some members of the elected body have claimed they were denied information by "council officers". The elected body has ample powers to obtain any financial information they want. Whether they did not know this, or did not know how to do this, they also failed to perform one of their most important responsibilities.
- I will be asking the Minister for Local Government for a further three-month appointment as Interim Administrator, to oversee the recruitment of a new CEO, to deliver a balanced budget for 2020/21 to oversee the introduction of appropriate financial reporting systems and the introduction of contemporary budgeting systems and practices.
- The new CEO will be mandated to deliver surplus budgets until working capital and reserves are restored to their appropriate balances.

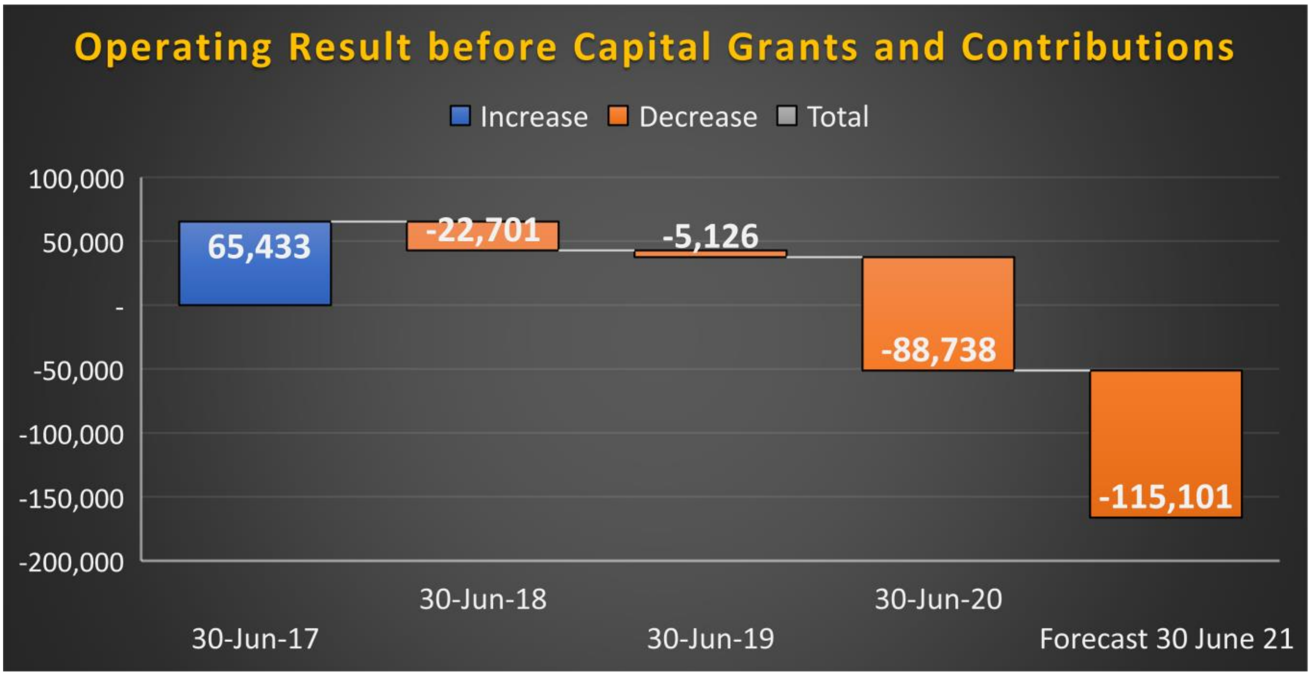
There are many Council staff working hard to deliver services to their community and in most cases they live here, it is literally their community. It is important that CCC residents not take out their frustrations on those valued public servants. What has occurred is not their fault.

Current Situation and How We Got Here

A catastrophic error of the amalgamated Council was their failure to understand that the organisation had less than $5m in unrestricted cash (excluding Water and Sewer Fund) at the beginning of amalgamation.

In the first year of operation, there was an operating surplus of $65m, which was predominantly driven by a one-off operating grant of approximately $40m.

Since amalgamation, Council's operating results before capital grants and contributions are shown in the graph below:



Graph 1: Operating Result before Capital Grants and Contributions

Since amalgamation, Council posted only one year of operating surplus (the first year) and that amounted to $65m. The cumulative losses for the following four years (including the projected loss for 2021) amounts to $232m.

As the Council started with less than $5m in unrestricted cash at amalgamation and then topped this by $65m (the first-year surplus) in 2017, this total of $70m was insufficient to cover the accumulated losses of $232m from unrestricted cash. Because Council did not have sufficient unrestricted cash (excluding Water and Sewer Funds), they continued to draw down restricted funds.

This indicates that until very recently there was no clear understanding of the impact that new service initiatives, along with vastly increased capital spending, was having on Council's liquidity.

A significant reason for the financial situation the Council now faces is that the Water Fund Externally Restricted Reserves and the Sewer Fund Externally Restricted Reserves were both understated by a total of $129.5m for 2018/19. This gave the impression that the $129.5m was unrestricted cash and therefore available to fund operating expenses.

This misunderstanding had a major effect on future budgets because capital expenditure, intended to be funded from unrestricted cash, was in fact being funded from restricted cash. Had this been understood, then strong budget management may have been able to respond and prevent the rapidly deteriorating situation a lot sooner. Capital and operational expenditure could have been cut more severely had it been understood that there was no unrestricted cash available.

Tragically the operating deficits accelerated, as did the capital program, as per the graph below:

This graph shows that between 2019 and 2020, the capital program increased by $69m which further exacerbated the net $166m cumulative losses explained in graph 1 above. This capital program increase was partially funded by a $50m loan in May 2020 which shows Council was aware it had run out of unrestricted cash to fund new capital expenditure.

The $166m in cumulative losses, plus the extra $69m additional capital expenditure (of which $22.5m was funded from the $50m loan) – amounts to approximately $200m in unrestricted cash deficit. This was unlawfully funded from Restricted Reserves.

The Three Big Issues

For ease of reading, the section deals with the main issues under three headings:

1. The misuse of Council’s Restricted Reserves;
2. The failure to manage Council’s budget from the time of amalgamation;
3. The failure to focus on achieving efficiency dividend/savings from the amalgamation.

Before dealing with these and other issues in detail, it is important to respond to two matters being aired, particularly on social media:

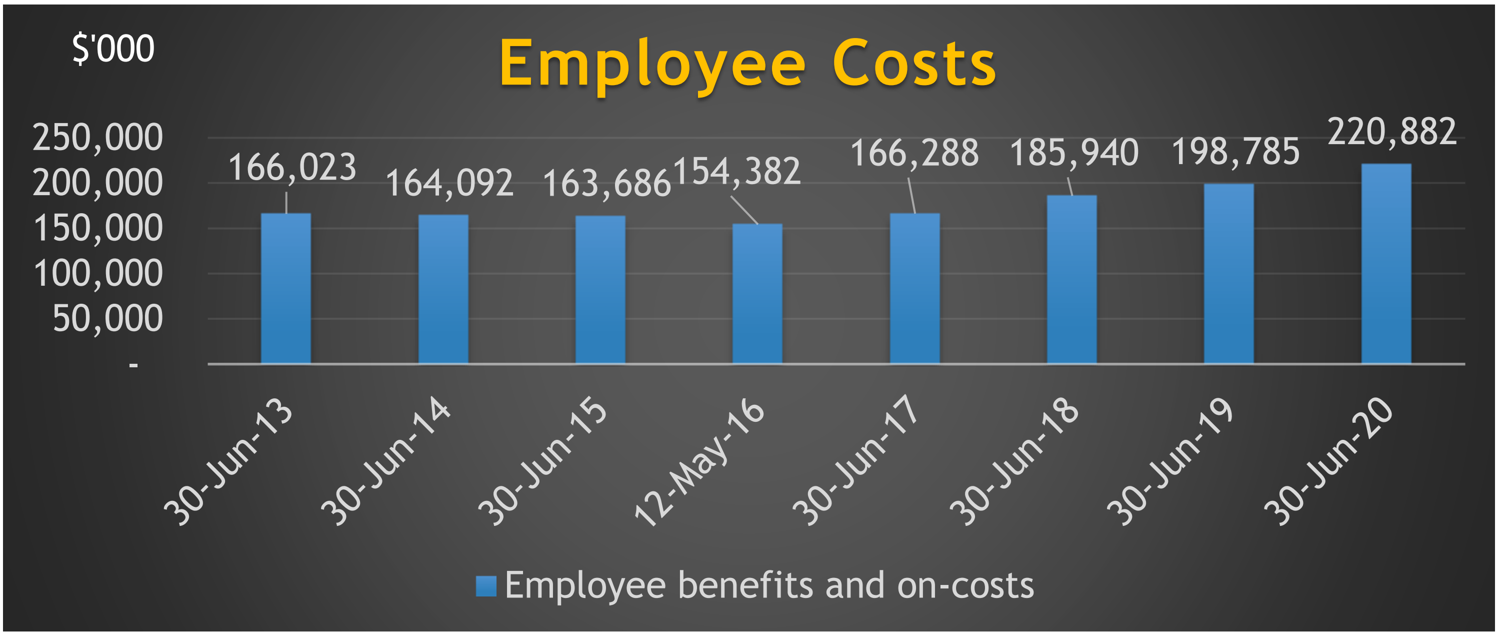
A. “This crisis must be caused by massive theft or corruption”.

Social media has given a platform to many, allowing the presentation of what are often referred to as ‘conspiracy theories’ as facts. All I can do is repeat the facts: There is NO EVIDENCE to support claims of theft or corruption.

B. The claim that CCC’s financial woes are due to the amalgamation is more complex. It is certainly not the major factor but it is true that it has contributed.

Expenditure on new IT and financial systems and infrastructure far exceeded the funds provided by the NSW Government, with additional IT spending [on top of the $10m provided] in the order of $50m once-off, and $8m recurrent.

Graph 3 below shows the upward trajectory of employee costs. Annual employee costs rose from $154m at amalgamation on 12 May 2016 to $221m on 30 June 2020.



Graph 3: Employee Costs trend, noting that the $154m cost as at 12 May 2016 is a normalised figure for 12 months. The published balance was $135m for 2016 and $187m for 2017.

The $54.6m employee costs increase from $166m in 2017 to $221m in 2020 is driven by the following:

- $12.5m due to Local Government State Award increases;
- $25.3m due to harmonisation costs associated with the Unified Salary Scale, 35/38 Hour Claims, travel and vehicle allowances;
- $12.7m in termination payments and associated costs such as annual and long service leave;
- Full time equivalents (excluding vacant positions) has risen from 1,875 in May 2017 to 2,117 in October 2020, an increase of 242.

1. RESTRICTED RESERVES

At a high level, the $166m in cumulative operating deficits, in addition to the extra capital load of $69m, excluding the portion funded by the $50m loan from May 2020, has led to approximately $200m reduction in reserves, bringing the reserves balance into a deficit.

The exact total of the deficit is subject to an ongoing forensic investigation. More information will be provided in my final report.

These provisions and requirements regarding Restricted Reserves are widely understood across councils in NSW.

Since 2019/20, $200m+ of Restricted Reserves have been either unlawfully used or used without the approval of Council.

All of these funds must be repaid and are effectively borrowings that need to be repaid.

Interrogation of Council's emails and notes systems shows clearly the both the CFO and the CEO were aware that Restricted Reserves were being used for both, purposes prohibited by the Act, and for purposes not approved by the Council.

2. BUDGET MISMANAGEMENT

The Operating results for Council outlined in graph 1 show the declining situation over a four-year period, moving from a $65m surplus in 2017, to a $13m projected deficit in 2020/21. The actual result is more likely to be a deficit in excess of $100m.

Managing the Council's financial position is the number one responsibility of the CEO.

Council, in their role as the Governing Body, shares that responsibility.

It is clear the CEO was either unaware of the looming crisis, or simply failed to adequately respond. Either way the performance of the CEO was unsatisfactory.

Many councillors claim they were unaware of the extent of the problem until it surfaced through a Council report on 12 October 2020. In speaking to 13 of the councillors many indicated they felt let down and in some cases, misled, by the CEO and CFO. Some felt they were denied the information they needed to fulfil their responsibilities.

Accepting their good intentions they did not, however, come to grips with this fundamental role of their position.

By April 2020 it was clear the primary challenge facing the Council was budget management. It is also clear that the savings targets set in the 2020/21 budget were not being achieved.

This was also the case in 2019/20, where it was clear in April that year that the targeted savings were not being achieved. The IPART decision in May 2019, reducing revenue by $39m, was another point where alarm bells were not responded to with further savings measures.

Claims that the CEO and CFO would not provide them certain financial information may well be true, but Council has the power to get whatever information it requested. Their failure to either understand this, or understand how to do this, represents a failure of one of their fundamental functions under the Local Government Act.

Council carries out a Performance Review for the CEO each year. This usually sees the CEO prepare a document outlining the proposed key performance indicators, the CEO's evaluation of his/her performance, space for the elected body's response and a space for each to provide a rating. The document prepared for the 2019/20 Performance Review included 6 criteria for financial performance. The self-assessment review conducted by the CEO for the next review in 2019/20 omitted the only 2 criteria that specifically dealt with meeting financial targets. While the review was not finalised, the draft includes the comments and rating of the elected representatives involved. They apparently did not notice or object to the omission. The deletion of these critical KPIs and the failure by councillors involved to detect these omissions, reflects very poorly on all involved.

3. AMALGAMATION SAVINGS

I have seen no evidence that the new Council made any serious attempts to identify the type of savings available from merging two large organisations. I am still seeking reports and information in this regard. I will have more to say on this topic in my final report.

Conclusion

The current financial position of the Central Coast Council is parlous, with Council again approaching serious liquidity problems as well as another operating loss in the order of $115m.

Total accumulated losses since amalgamation are over $166m.

At the end of this financial year total council debt will have increased from $317m at time of amalgamation to an estimated $565m at the end of the current financial year (inclusive of $200m of Restricted Reserves to be repaid).

Staff costs have risen by 43 per cent since amalgamation (using the normalised cost of $154m as the starting base) while revenue has risen by only 6 per cent.

Staff numbers have risen by 13 per cent, from 1875 to 2117, an increase of 242.

Acknowledging a range of variables like the IPART decision, the impact of fires, COVID-19 and increases in IT costs were beyond the Council's control, they were known and the real failure of both the organisation and the elected body is one of budget/financial management. This is particularly the case for the current financial year.

Actions are in-train to deal with this situation, however the willingness of lenders to provide necessary further loans [either private or public] is totally dependent upon the Council embarking on an urgent turnaround strategy to ensure next year's budget is at least 'break even'.

These measures will need to include:

- Significant asset sales of at least $40m;
- Further borrowings;
- A substantial rate increase;
- An increase in some Council charges;
- A major reduction in Council's senior and middle management numbers;
- A reduction in staff numbers to return to the level at the time of amalgamation.

Council needs to introduce comprehensive reforms to its' budgeting and financial reporting systems to ensure that not only are they aware of what is happening, but that the community also have a transparent view of Council's financial position.

I will be seeking a three-month extension from the Minister for Local Government to ensure these measures are put in place, along with the recruitment of a new CEO with the necessary expertise and experience to lead the organisation into what I believe can be a strong and prosperous future.

On behalf of the Council, I acknowledge the hardship these actions will cause and sincerely apologise for the real impact previous financial mismanagement will have on all residents and ratepayers of the Central Coast.

Dick Persson AM
Interim Administrator
2/12/2020

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