



Guyra Shire Council

Fit for the Future - Asset Reporting

June 2015



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Background



- Council has requested that Morrison Low undertake an urgent review of Council's asset and financial data to ensure that Council infrastructure reporting is consistent and realistic
- To provide this assessment, a high level review of Council's asset and financial data was carried out and discussion held with Council's General Manager and the relevant finance and asset staff
- Modelling was also undertaking to see the impact of any changes on Council's forecast performance against the benchmarks





Special Schedule 7



- What is Special Schedule 7? (from accounting standards)
 - Required by the OLG to monitor the condition of public works and the extent to which councils are able to maintain public assets
 - The schedule requires councils to determine the estimated cost to bring infrastructure assets to a satisfactory condition (Cost to Satisfactory)
 - In determining the Cost to Satisfactory (C2S) councils should be estimating, in current dollars, the amount required to be spent on existing infrastructure only
 - All costs must be limited to providing the 'existing' service, not an improved one
 - The C2S is a reporting requirement for SS7 and is different to, and not comparable to, the planned or forecast asset renewal expenditure. Insufficient renewal expenditure will leave assets in poorer condition which will be reflected in a higher C2S
 - The level of 'satisfactory' condition is considered to be condition 2 unless the community has been consulted

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Special Schedule 7 (cont.)



- The required annual maintenance is the amount that should be spent to maintain assets in a satisfactory condition
- It is important to note that C2S does not include requirements for expanded and new assets or assets that are under capacity or not meeting existing service requirements
- Councils are also required to report on the actual maintenance expenditure expended on assets as well as the required maintenance expenditure for each asset class
- The OLG provides no guidance as to how the required maintenance or the C2S are to be calculated



Cost to Satisfactory



- The OLG has provided little guidance on the determination of C2S
- Consequently, across the state there are a number of different approaches to its determination
- In our opinion, C2S must be based on asset condition as a primary driver to the determination of C2S
- The C2S and subsequent backlog ratio are indicators of the overall condition of a council's assets
- In our opinion, this should be done at a network level rather than an individual asset level
- It should be noted that, under the Fit for the Future guidelines, the backlog ratio excludes water and sewerage assets





Condition Assessment



- Council should use a common condition matrix for each of the different asset groups. Typically, councils use different condition matrices for different asset groups
- Below is an example of an expanded condition matrix that is generally consistent with the International Infrastructure Management Manual – 2011

Condition Rating	Condition	Descriptor	Guide	Residual Life as a % of Total Life	Mean %age residual life
1	Excellent	Sound physical condition. Asset likely to perform adequately without major work.	Normal maintenance required	>86	95
2	Good	Acceptable physical condition, minimal short term risk of failure.	Normal maintenance plus minor repairs required (to 5% or less of the asset)	65 to 85	80
3	Satisfactory	Deterioration evident, failure in the short term unlikely. Minor components need replacement or repair now but asset still functions safely.	Significant maintenance and/or repairs required (to 10 - 20% of the asset)	41 to 64	55
4	Worn	Deterioration of the asset is evident and failure is possible in the short term. No immediate risk to health and safety.	Significant renewal required (to 20 - 40% of the asset)	10 to 40	35
5	Poor	Failed or failure is imminent or there is significant deterioration of the asset. Health and safety hazards exist which present a possible risk to public safety.	Over 50% of the asset requires renewal	<10	5





Condition Assessment (cont.)



- The Office of Local Government (OLG) provides some guidance by way of the Integrated Planning and Reporting Guidelines. In general terms:
 - in order to achieve consistency across the NSW local government sector it is necessary to define what is meant by 'satisfactory standard'
 - satisfactory is defined as "satisfying expectations or needs, leaving no room for complaint, causing satisfaction, adequate"
 - with this in mind, OLG has established that the level of satisfactory standard for public works should be good (level 2) based on their current condition matrix below

Level	Condition	Description
1	Excellent	Normal maintenance
2 Good		Some surface/pavement structure deterioration – patching only needed for repair
3	Average	Serious surface/pavement structure deterioration- requires resurfacing or recycling of pavement structure
4	Poor	Deterioration materially affecting entire surface/pavement structure- requires renovation within one year
5	Very poor	Deterioration is of sufficient extent to render the surface/pavement structure unserviceable

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Condition Assessment (cont.)



- In our opinion, when comparing the OLG condition matrix to the IIMM condition matrix, we consider that condition 3 is comparable to the OLG condition 2
- Recommendation
 - That Council undertake a community engagement program to determine the community desire regarding asset condition
 - That Council formally adopt condition 3 as satisfactory condition





Required Maintenance



- SS7 also requires that councils compare the actual annual maintenance on the various classes of assets with the required maintenance spend
- Required annual maintenance is the amount of money that should be spent to maintain assets in a satisfactory condition
- What is maintenance expenditure?
 - Expenditure that ensures the asset reaches its useful life
 - Maintenance expenditure does not extend the life of the asset
- At a network level it could be expressed as a percentage of the replacement cost of the assets





Required Maintenance (cont.)



- Increases in Council's asset portfolio will result in an increase in maintenance liability. This is a reasonable assumption especially when a complete network view of the assets is used
- Where a council componentises an asset to better reflect the consumption of the asset, different maintenance rates are able to be applied to the asset components to further improve the estimate of required maintenance
- For the purpose of SS7 we have looked at what similar councils are doing in relation to maintenance expenditure on assets
- We have also used known industry benchmark data to determine required maintenance expenditure
 - In the longer term, trends in asset condition can also indicate the impact that expenditure is having on assets





Standardised Methodology for Calculating Special Schedule 7



- Morrison Low has developed a standardised methodology for determining Special Schedule 7 requirements, which is summarised below
 - Assume that satisfactory condition is 3
 - Take an asset network, rather than an individual asset, approach
 - The cost of bringing condition 4 assets to condition 3?
 - The cost of bringing condition 5 assets to condition 3?
 - Utilise the Council's condition matrix to determine what the difference is between a condition 3, 4 and 5 asset
 - Knowing the current replacement cost of the assets we can apply a percentage of the current replacement cost of assets in condition 4 and 5 to determine the C2S
- The next chart shows how these percentages are determined

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Standardised Methodology for Calculating Special Schedule 7 (cont.)



Condition Score	1	2	3	4	5	
Defect %	0%	0 - 5%	5 – 20%	20 - 40%	40 - 100%	
Average defect %	0%	2.5%	12.5%	30%	70%	

Represents approximately 17.5% of asset value

Represents approximately 57.5% of asset value







Standardised Methodology for Calculating Special Schedule 7 (cont.)



- The reality is that a council would never renew an asset in condition 5 or condition 4 to condition 3
- Renewal work would generally return the asset to condition 1 or 2
- Taking a network view means the Cost to Satisfactory is an indicative cost required to bring the whole asset portfolio up to a satisfactory standard
- As such, the Cost to Satisfactory is calculated by adding the cost to bring condition 4 assets to condition 3, and the cost to bring assets in condition 5 to condition 3





Assessment Tool



- Morrison Low has developed a model that uses the methodology documented in this report
- The model requires Council to update the condition matrix for each asset class on an annual basis
- Once this data is determined it can be input directly into the model to determine the C2S
- In relation to the determination of required maintenance, Morrison Low has assembled a benchmarking table that lists the maintenance information provided by a number of NSW councils and generates a percentage parameter to link benchmarked required maintenance with asset replacement value





Assessment Tool (cont.)



- The benchmarking data has been applied to the asset class value information provided by Guyra Shire Council to compare the benchmarked, required and actual maintenance expenditure schedules related to Special Schedule 7
- Council was asked to supply a condition matrix setting out the percentage of each asset in condition 1 – 5, by class and value (Current Replacement Cost). In some cases, due to the short time available, Council could not supply that data. Where that was the case, a proxy of the published information of percentage of each asset in condition 1-5 by class and value (Written Down Value) has been used





Assessment Results



The table below shows the summary of the asset groups and highlights the backlog or C2S and the backlog ratio. The backlog ratio of 2.9% is above the benchmark of 2%. It should be noted that, under Fit For the Future, water and sewerage assets are excluded from the backlog ratio calculation

Assets	Replacement Cost		Depreciated value			Backlog	Backlog Ratio
Buildings	\$	28,372	\$	14,038		\$ 1,937	13.80%
Other Structures	\$	6,036	\$	3,083		\$ 931	30.20%
Roads Assets	\$	126,267	\$	103,966		\$ 1,079	1.04%
Stormwater Drainage		19,129	\$	16,326		\$ 62	0.38%
Open Space/Recreational Assets		858	\$	500		\$ 5	0.90%
Other Infrastructure Assets		-	\$	-		\$ -	
Water Supply Network		-	\$	-		\$ -	
Sewerage Network		-	\$	-		\$ -	
Total	\$	180,662	\$	137,913		\$ 4,013	2.91%



Assessment Results (cont.)



- The table below highlights the revised required maintenance and the maintenance ratio for Guyra, based on our assessment
- It is assumed that the actual maintenance figure is as reported by Council
- The overall and general asset maintenance ratio is above the 100% benchmark

Assets		Gross Replacement Cost		Written Down Value		Actual mainatenance		Estimated Required Maintenance		Maintenance ratio	
Buildings	\$	28,372.00	\$	14,038.00		\$	80	\$	596	13.43%	
Other Structures	\$	6,036.00	\$	3,083.00		\$	2	\$	91	2.21%	
Roads Assets	\$	126,267.00	\$	103,966.00		\$	720	\$	607	118.55%	
Stormwater Drainage	\$	19,129.00	\$	16,326.00		\$	-	\$	180	0.00%	
Open Space/Recreational Assets	\$	858.00	\$	500.00		\$	-	\$	26	0.00%	
Other Infrastructure Assets	\$	-	\$	-		\$	-	\$	-	-	
Water Supply Network	\$	-	\$	-		\$	-	\$	-	-	
Sewerage Network	\$	-	\$	-		\$	-	\$	-	-	
Total	\$	180,662	\$	137,913		\$	802	\$	1,500	53.5%	



Asset Depreciation



- Based on the limited information provided, we consider that the annual depreciation set out in the 2013/14 annual statements would appear to be high
- We understand that some additional stormwater assets will be brought to account in the 2014/15 roads revaluation, and that the revaluation will lead to a decrease in the annual infrastructure depreciation in the order of \$350,000
- We note that in 2013/14 a revaluation of the building assets has lead to a significant increase in buildings depreciation approximately \$500,000
- Based on comparison of similar councils, the buildings depreciation expressed as a percentage of the Gross Replacement Cost of infrastructure assets varies between 1.1% and 2.4%
- Guyra's building depreciation sits at the higher end of the range at 2.3%
- It is reasonable to expect that a review of the buildings revaluation and depreciation will lead to a decrease in annual buildings depreciation





Observations



- The largest infrastructure backlog occurs in the road and buildings asset categories
- This is generally consistent with most other local councils
- Council has good, up-to-date and accurate information on its road assets.
 Consequently, the estimate of backlog for roads is reasonably reliable
- The condition data of buildings is generally aged-based and may vary to some degree due to utilisation and use of the facility. It is considered that asset condition data in this area is, at best, uncertain
- Improvement in condition assessment of buildings will provide greater certainty and confidence of the backlog in this asset class





Observations (cont.)



- As part of the staged process of auditing Special Schedule 7, the OLG has indicated that it will ask the auditors to provide comment on councils' preparedness for auditing of Special Schedule 7
- The auditors will be asked to provide comment on the following aspects of a council's asset management systems:
 - Asset knowledge and data
 - Strategic asset planning processes
 - Operations and maintenance work practices
 - Information systems
- The auditing guidelines follow a similar process to that adopted by the NSW Infrastructure Audit 2012
- Council should review the 2012 Infrastructure report to ensure that it understands what will be required of Council to meet future audit requirements

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Observations (cont.)



- Council should consider undertaking a follow up asset management audit, not only to ensure that the requirements of SS7 are met but to ensure a consistent approach to asset management across the organisation
- As with most audits, the adoption of an improvement program will help ensure that the future compliance requirements are met
- We have estimated that the current required maintenance expenditure on all assets is approximately \$1.5m compared to an actual maintenance expenditure of \$802k
- In our opinion, renewal expenditure provides better value to Council in terms of the overall management of its infrastructure assets. It is not clear if the systems and processes are in place to ensure that maintenance and renewal expenditure is fully and correctly accounted for
- It is essential that these processes are in place so that Council is reliably informed of what is being spent and what is required to be spent on its infrastructure assets





Modelling



- Taking into account the updated information (required maintenance and estimated cost to satisfactory) Morrison Low has projected Council's performance against the benchmarks into the future
- Two scenarios were modelled to show the impact of the changes described in this report
 - Base case
 - Updated
- The following assumptions were made in the modelling
 - Projections are based on information provided by Council
 - Required maintenance is as set out in this report
 - Estimated cost to satisfactory is as set out in this report
 - The model prioritises renewal expenditure to ensure that the backlog ratio is meet prior to reallocating funds to asset maintenance

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Modelling (cont.)



The updated Modelling assumes the following improvement opportunities

No	Efficiency Initiative	Implementation yr.	Saving	\$(,000)
1	Continue to purchase the following: IT Services, Finance and Accounting Services, Fleet Management Services, Human Resource Functions			
2	Pass on the Ongoing management and operation of community support services to a regional provider	2017	\$	42
3	Establish a New England Regional Library Service that manages and delivers each of the libraries in the NE Region	2017	\$	18
4	Resource sharing within internal Council functions, through renovations to combine library and customer service (Capital)		\$	30
5	Hostel Accommodation Business (Capital)		\$	350
6	Hostel Accommodation Business	2017	\$	300
7	Sale of Effluent to horticultural Industry	2017	\$	24
8	Reduce the number of mandatory Council meetings to 6	2016	\$	37
9	Joint Organisation to become the member organisation for peak bodies & rep groups to reduce subscriptions & fees imposed on individual councils	2016	\$	20
10	Sale of Surplus assets: Tingha RTC, Low Income Flats, Drs Residence,	2016	\$	25
11	Implement a more affordable website service reducing annual fees	2016	\$	6
12	30% Special Rate Variation	2017	\$	830
13	Service reviews across the organisation	2017	\$	100
14	Service reviews across the organisation	2022	\$	100
15	Review buildings depreciation	2016	\$	100

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Summary of performance against the ratios to 2020



Indicator	Base Case	Updated
Operating Performance	×	\checkmark
Own Source Revenue	\checkmark	\checkmark
Debt Service Cover	\checkmark	\checkmark
Asset Maintenance	×	\checkmark
Asset Renewal	×	\checkmark
Infrastructure Backlog	×	\checkmark
Real Operating Expenditure	\checkmark	×













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Conclusions



- The estimated Cost to Satisfactory condition for infrastructure assets is a key parameter in the Special Schedule 7 report
- There are numerous ways to calculate Cost to Satisfactory for SS7
- To establish a robust calculation methodology, Guyra Shire Council should:
 - review their condition ratings with a view to endorsing condition 3 as a 'satisfactory' asset condition for reporting to Special Schedule 7
 - confirm the defect counts and hence a percentage of renewal cost allocations for each of the asset condition ratings
 - confirm the distribution of the assets by value across the condition ratings
 - apply an assessment tool developed by Morrison Low to arrive at a cost to bring infrastructure assets to a satisfactory condition, taking each asset class as a whole network





Conclusion (cont.)



- Based on the information available, the overall cost to bring infrastructure assets to a satisfactory condition has been assessed by Morrison Low at \$4.0m against a replacement value of \$181m
 - The backlog ratio has been calculated at 2.9% against a benchmark of 2%
- Council has used the benchmarking maintenance data assembled by Morrison Low to allow the required and actual asset maintenance expenditure to be compared with the average figure indicated across a number of NSW councils
 - Based on the information available, the annual maintenance spend for all asset classes is \$802k. The estimated required spend is \$1.5m. This represents an asset maintenance ratio of 53.5% on a one year basis
- Modelling projected performance against the Fit for the Future benchmarks using these figures provides Council with an improved performance which sees all ratios met by 2019/20, except the operating performance per capita measure





Recommendations



- That Council formally adopt condition 3 as satisfactory condition
- That condition 3 in the Council's condition matrix be identified as satisfactory
- That Council adopt a common methodology for the determination of Special Schedule 7 that can be used by all asset classes across the organisation
- That Council undertake a community engagement program to determine the community desire regarding asset condition
- Council review infrastructure depreciation to ensure that it is accurately accounting for the cost of its assets





Next Steps



- Adopt common methodology for calculating Special Schedule 7
- Prepare for an audit of asset management systems
- Consider benchmarking actual and required maintenance results for major asset classes
- Reconsider current maintenance allocations and redirect this funding towards renewal expenditure where required
- Identify service review opportunities across the Councils operations
- Review depreciation





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