APPENDIX 5
ATTACHMENT 1

KPMG

Depreciation Review

For the City of Joondalup

February 2019

KPMG

Private & confidential

235 St Georges Terrace
Perth WA 6000

GPO Box A29
Perth WA 6837
Australia

ABN: 51 194 660 183

Telephone: +61 8 9263 7409
Facsimile: +61 8 9263 7129

www.kpmg.com.au

Mr Roney Oommen
Manager Financial Services
City of Joondalup
9 Boas Avenue
Joondalup WA 6027

5 February 2019

Dear Roney

DEPRECIATION REVIEW AND ANALYSIS

We appreciate the opportunity to have assisted the City of Joondalup (the City) with the provision of accounting advisory services in relation to the review of your depreciation values. Our work included a review and assessment of your methodology and processes around fair value accounting, useful life estimates, replacement costs and budgeting for Buildings, Drainage and Transport assets, as set out in our proposal dated 9 May 2018.

Scope

In summary, the purpose of our Engagement was to assist the City by reviewing and providing advice on the principles and methodologies around depreciation values for the above assets in 2016-17, with specific regard and reference to:

a) Revaluations:

- Whether revaluations been accounted for in accordance with local government legislation and accounting standards;
- How depreciation has been impacted by these revaluations; and
- The impact of any non-compliance with accounting standards on depreciation values in 2016-17.

b) Process review:

- What processes the City should have in place to ensure that depreciation is correctly calculated following revaluation;
- What processes the City should have in place to ensure accurate estimates of depreciation for inclusion into the annual budget;
- What processes the City should have in place to ensure accurate forecasts of impairment amounts for inclusion into the annual budget; and
- Documenting current processes.

c) Useful lives:

- A review of the City's useful lives (historical data vs benchmarks)
- Compliance with accounting standards;
- What processes the City should have in place to ensure that useful lives used are optimal to the City's assets; and
- Advice around whether the City should engage independent third parties to do peer reviews of its useful life estimates, and best practice to apply to peer reviews.

As of the date of this report, we have completed all services as provided in our Engagement Letter. This deliverable is in final form and supersedes all draft versions of our advice.

Please contact me if you have any questions. We thank you and personnel involved for all the assistance provided in conducting this engagement, and we look forward to continuing to provide service to your organisation.

Yours sincerely

MC Day

Michael Day
Director, KPMG

Limitations & scope exclusions

KPMG

Inherent limitations

This report has been prepared at the request of the City of Joondalup for the Provision of Accounting Advisory Services issued under CUA 23706, and based on the Scope outlined in this deliverable. The ultimate responsibility for the accounting treatment of any matter rests with the preparers of the financial statements, including the City of Joondalup's directors and management.

The services provided in connection with the engagement comprise an advisory engagement which is not subject to assurance or other standards issued by the Australian Auditing and Assurance Standards Board and consequently no opinions or conclusions intended to convey assurance will be expressed.

No warranty of completeness, accuracy or reliability is given in relation to any statements and representations made by, and the information and documentation provided by, management and personnel of the City of Joondalup who were consulted as part of the process.

We have not sought to independently verify any information provided to us.

The advice provided in this deliverable is based upon the facts and circumstances provided to us and the assumptions you have advised we should make.

The City of Joondalup is responsible for ensuring:

- the facts, circumstances or assumptions regarding subject matter / transaction do not differ from those provided to us; and
- complete and accurate information has been provided to us, including details of other contracts or arrangements, whether documented or orally agreed, which impact upon the overall substance of the subject matter / transaction.

If you have not fulfilled these responsibilities, our advice may not be valid. We have not sought to independently verify any information provided to us.

Where regard is made to accounting standards in this deliverable, any advice is based on interpretations of accounting standards and other relevant professional pronouncements and legislation current at the date of preparing the advice, Should the accounting standards, other relevant professional pronouncements or legislation change, the advice may not be valid.

KPMG is under no obligation in any circumstance to update this report, in either oral or written form, for events occurring after the report has been issued in final form.

Third party reliance

This deliverable is solely for the purpose set out in the Scope section and for the City of Joondalup's information, and may not be used for any other purpose or provided or distributed to, or accessed or relied upon by, any other party without KPMG's express written consent. Other than our responsibility to the City of Joondalup, neither KPMG nor any member or employee of KPMG undertakes responsibility arising in any way from reliance placed by a third party on this deliverable. Any reliance placed is that party's sole responsibility.

We understand that this deliverable may be provided to the external auditors of City of Joondalup. The external auditors of the City of Joondalup are not a party to our engagement letter with the City of Joondalup and our engagement was neither planned nor conducted in contemplation of the purposes for which City of Joondalup's external auditor may access this deliverable. The City of Joondalup's external auditor is responsible for forming their own audit opinion. Accordingly, the City of Joondalup's external auditor may not place reliance on this deliverable. KPMG is not liable for any losses, claims, expenses, actions, demands, damages, liabilities, or any other proceedings arising out of any reliance by the City of Joondalup's external auditor on this deliverable.

Glossary

Below are various abbreviations used throughout this report.

AASBs	The Australian Accounting Standards Board, and associated interpretations and accounting standards
CV	Carrying Value
EOFY	End of Financial Year
EUL	Expected Useful Life
FAR	Fixed Asset Register
FV	Fair Value
GRV	Gross Replacement Value
IAMT	Infrastructure Asset Management Team
LGA	Local Government Area
NFP	Not-for-profit
NBV	Net book value
OCI	Other Comprehensive Income
P&L	Profit or Loss/Income Statement
PPE	Property, plant and equipment
TB	Trial Balance
The City	The City of Joondalup

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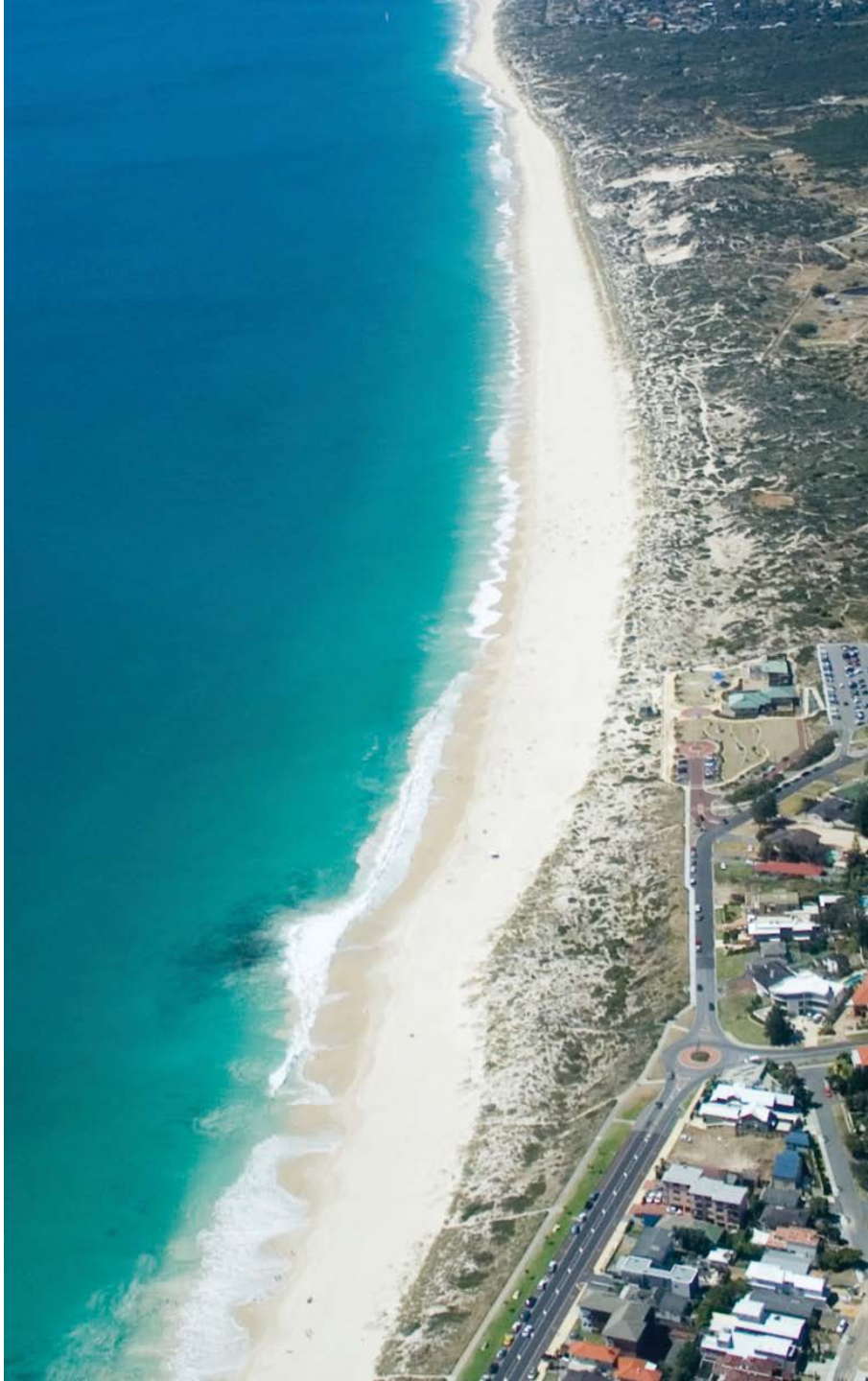


Executive Summary

Executive Summary

The City of Joondalup is responsible for a large portfolio of assets, representing significant investment of public funded resources, which are used to deliver services to the community. Assets are managed and maintained to provide a certain level of service to the community. These assets include land and buildings, plant and equipment and infrastructure assets consisting of roads, car parks, footpaths, drainage, bridges and underpasses, irrigation, lighting and marine assets.

This report relates to the following 3 classes of assets:

- Buildings
- Drainage; and
- Transport.

These 3 classes of assets make up 64% of the total assets as per the City's statement of financial position as at 30 June 2017.

The value of the City's assets, and the use of fair value accounting, is critical to assessing the real performance of the entity and may assist in providing meaningful information about asset management performance.

Headline Finding: The City of Joondalup adopts fully compliant depreciation methodologies. I.e. depreciation methods used, the identification of significant components and assumptions around residual values and useful lives adopted are in accordance with accounting standards and other applicable accounting requirements.

Key challenges				
Accurate accounting for fair values, useful life estimate and depreciation is important. Oversimplifying or ignoring key aspects of accounting standards has the risk of producing materially incorrect results.	Inability to assess the performance of the entity where significant differences in the calculations of fair value and depreciation expense between asset accounting and asset management.	With a large portfolio of assets, it's more critical that fair value and depreciation figures reflect the reality of where an asset is within its lifecycle and the rate at which the asset's service potential is being consumed.	Effective internal controls, policies and procedures over assets could result in a lack of data integrity and recording incorrect asset values.	

1	Depreciation review	**Work performed** KPMG considered the appropriateness of the City's methodology adopted around accounting for asset revaluations and depreciation specifically looking at useful lives, depreciation methods, accounting for revaluation adjustments, componentisation and residual values. In addition to ensuring compliance with accounting standards and other applicable accounting requirements, depreciation and revaluation calculations were tested for a sample of assets. **Key Findings & Recommendations** Key findings and recommendations are summarised and documented on pages 9 to 18. Furthermore a benchmarking analysis was performed with the objective of determining best practice and providing some key insights into depreciation rates and useful lives adopted by similar entities (refer pages 19-22).
2	Current State Analysis (key processes)	**Work performed** KPMG obtained current process documentation and held discussions, including a workshop with key stakeholders, to confirm and document key processes around fixed assets. KPMG has documented these processes using flowcharts and reviewed key controls to identify key gaps and inefficiencies. As a result, various pain points were identified and categorised based on occurrence and impact. A RACI matrix has been used to identify roles and responsibilities representing a preferred future state to be implemented by the City of Joondalup. **Key Findings & Recommendations** Key findings and recommendations are summarised and documented on pages 23 to 33.

Depreciation Review

Work performed

Presented opposite are extracts from the City of Joondalup's Annual Financial Report 2016/2017.

Property, Plant and Equipment (PPE) primarily consists of Land, Buildings and other Plant and Equipment. Infrastructure Assets primarily consists of Roads, Footpaths, Car Parks, Drainage, Bridges and Underpasses, Lighting and Other Infrastructure assets.

Refer to the latter part of this section of the report for work performed over key assets and depreciation amounts.

CITY OF JOONDALUP
STATEMENT OF FINANCIAL POSITION
AS AT 30 JUNE 2017

	NOTE	2017 $	2016 $	01 July 2015 $
CURRENT ASSETS				
Cash and Cash Equivalents	7	91,237,574	86,595,746	89,170,901
Trade and Other Receivables	8	3,934,437	4,621,753	4,718,551
Inventories		144,976	70,380	70,370
TOTAL CURRENT ASSETS		95,316,987	91,287,879	93,959,822
NON-CURRENT ASSETS				
Non-Current Receivables	8	1,755,733	1,605,991	1,520,537
Equity Investments	9	7,569,959	8,861,001	8,628,975
Property, Plant and Equipment	10	465,742,284	341,472,553	294,085,611
Infrastructure Assets	11	954,793,693	997,495,394	997,468,666
TOTAL NON-CURRENT ASSETS		1,429,861,669	1,349,434,939	1,301,703,789
TOTAL ASSETS		1,525,178,656	1,440,722,818	1,395,663,611

4. REVENUE AND EXPENSES	Note	2017 Actual $	2017 Budget $	2016 Actual $
Depreciation, Impairment & Revaluation Decrement				
Buildings		4,354,703	5,096,361	5,008,526
Furniture and Equipment		538,516	324,010	481,728
Plant and Equipment		1,535,496	1,382,273	1,396,965
Parks and Reserves		4,081,939	3,627,984	3,938,226
Roads		11,607,928	11,582,712	11,380,233
Footpaths		2,058,232	1,871,316	2,018,679
Drainage		4,190,570	4,151,644	4,171,439
Bridges and Under Passes		346,947	346,514	346,613
Lighting		1,056,303	-	1,009,823
Other Infrastructure		420,075	1,105,823	285,170
Impairment/Revaluation Decrement		2,428,173	-	1,488,713
		32,618,882	29,488,636	31,526,115

KEY FOCUS AREAS

PPE and Infrastructure Assets

- Assessing whether revaluations of the City's Buildings, Drainage and transport assets have been accounted for in accordance with relevant accounting standards and local government legislation
- Determining how revaluations should be accounted for and recorded
- Reviewing the practices and processes adopted for asset creations and subsequent revaluations
- For self-constructed assets, ensuring that assets are appropriately capitalised when ready for use
- Re-performing valuation calculations

Depreciation and write-offs

- Assessing the impact of revaluations on depreciation of PPE and Infrastructure Assets
- Reviewing the practices and processes around depreciation and budgeting for depreciation and write-offs
- Assessing the patterns of consumption of future economic benefits embodied in assets and the methodology used to determine useful lives applied to the City's assets.
- Consideration of best practice and appropriate benchmarking analysis
- Consideration of the appropriateness of adopting residual values
- Ensuring assets are depreciated from when assets are available for use
- Re-performing depreciation calculations
- Consideration of the appropriateness of the City's componentisation policies

Revaluations

Summary of key accounting requirements

- If an entity elects to measure a class of PPE at fair value, AASB 116 requires that all assets within the class also be revalued.
- Revaluations should be kept up to date, such that the carrying amount of an asset at the reporting date does not differ materially from its fair value.
- In respect of NFP entities, revaluation increases and revaluation decreases relating to individual assets within a class of PPE shall be offset against one another within that class but shall not be offset in respect of assets in different classes.
- In respect of NFP entities, if the carrying amount of a class of assets is increased as a result of a revaluation, the net revaluation increase shall be recognised in OCI and accumulated in equity under the heading of revaluation surplus. However, to the extent that it reverses a net revaluation decrease of the same class of assets previously recognised in P&L, the net revaluation increase shall be recognised in P&L.
- Similarly, if the carrying amount of a class of assets decreased as a result of a revaluation, the net revaluation decrease shall be recognised in P&L except to the extent of any credit balance existing in any revaluation surplus in respect of that same class of asset. In this instance the net revaluation decrease shall be recognised in OCI.
- When PPE is revalued, an entity accounts for the revaluation using either the restatement approach (where the gross carrying amount is adjusted) or the elimination approach (where the accumulated depreciation is eliminated against the gross carrying amount of the asset)

[AASB 16.31, 35, 39-40]

The City of Joondalup controls a portfolio of assets which are used to deliver services to the community which are measured at fair value.

The fair value method provides significant advantages over historical cost accounting for these types of assets because the information provided in the financial statements allows the users of the financial statements a greater understanding of the value of assets controlled by the entity and performance of the entity.

The use of fair value in the public sector is essential to assessing the real performance of the entity and may assist in asset management performance. However, it is critical that such figures reflect the reality of where an asset is within its lifecycles and the rate at which the asset's service potential is being consumed.

Key findings

- The methodology adopted for revaluations by the City is considered appropriate and, other than for the below mentioned, is in compliance with accounting standards and the requirements of the Local Government (Financial Management) Regulations 1996 Act.
- It was noted that management do not comply with the requirements of 116 paragraphs Aus39.1, AU40.1 and Aus40.2 requiring revaluation increments and decrements for individual assets within an asset class be off-set against each other and only the net increase or decrease recognised in either OCI or P&L. Currently the requirements of the standard are applied on an individual asset basis.
- The journals to account for the revaluation adjustments at 30 June 2017 were not in accordance with the approach for restatement under the accounting standard. Although the gross carrying amount was restated in proportion to the change in fair value, no proportionate adjustment to accumulated depreciation was made.

Recommendations

- We recommend reviewing the differences identified to assess their significance and if necessary, undertake further analysis to determine the amount of any potential adjustments required.

Revaluations (cont.)

Analysis

KPMG performed a review of the City's revaluation processes and accounting for revaluations for buildings, transport and drainage assets. Such review procedures included the following:

- *Consideration of the City's methodology adopted for revaluations including compliance with accounting standards and other applicable accounting requirements*

  In accordance with the City of Joondalup's accounting policy, PPE assets are carried at fair value and revalued at the individual component level every 3 years to comply with the mandatory measurement framework prescribed by the Local Government (Financial Management) Regulations 1996 Act* (the Act). The current Act requires the following:

  - The value of an asset shown in a local government's financial reports must be fair value of the asset; and
  - Assets must be valued by the expiry of each 3 yearly interval, as based on the value of the asset as at a time that is as close as possible to the day by which the revaluation is due.

  *Note: Per the newly issued Act, Regulation 17A, a Local Government must revalue an asset whenever local government is of the opinion that the FV of the asset is likely to be materially different from CV and, in any event, within a period of at least 3 years but no more than 5 years after the date previously revalued.

  Unless a trigger event is identified as part of the assessment of the asset's condition or performance indicating that the carrying amount of the asset differs materiality from its fair value, no interim valuations are performed via the use of indexation.

  Valuations are performed at a component level as follows:

Asset type	Valuation type
Buildings	External
Bridge and Underpasses	External
Transport – Paths, Road and Car parks	Internal
Drainage	Internal

  An appropriate peer review is performed where internal valuations are performed. It was noted that processes and assumptions applied in the FY2016/17 internal valuation can be considered appropriate.

  The City adopts the restatement (cost) approach when accounting for revaluations which requires the determination of a Gross Replacement Cost and then deducting Accumulated Depreciation in order to determine the Fair Value (Current Replacement Cost).

- *Consideration of journals for revaluations*

  Assets are revalued effective the end of the financial year, with revaluation adjustments processed at 30 June. In the case of not-for-profit entities AASB 116 provides that the increments and decrements for individual assets within an asset class are to be off-set against each other and the net increase or decrease adjusted as one entry for the asset class to OCI or P&L as appropriate provided that revaluation increases and decreases are not offset in respect of assets in different classes.

  Management currently do not adopt this approach required by the standard, but rather account for any increments or decrements on an individual asset basis.

- *Re-performing valuation calculations*

  For the class of assets being revalued, a revaluation worksheet is prepared and uploaded into TechOne containing the asset's gross replacement cost and restated accumulated depreciation amount. KPMG re-performed the revaluation adjustments for FY2016//17 for a sample of assets selected for each Bridges and Underpasses, Buildings, Paths, Roads and Car Parks, Drain Pipes and Drain Pits. The following was noted:

  I. Where valuations are external, gross replacement costs for asset components are as per the external valuation reports.

  II. Where valuations are internal, unit rates adopted are as per approved unit rates calculated by material type using capital works replacement projects. These approved unit rates are used to calculate the asset's replacement cost.

Revaluations (cont.)

Analysis (cont.)

III. For those assets selected for testing as part of the FY2016/17 revaluation process, it is noted that although the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset (i.e. restated in proportion to the change in the carrying amount), no proportionate adjustment to accumulated depreciation was made. The impact of this was as follows for those assets selected for testing:

- For revaluation increments – accumulated depreciation remained unchanged post revaluation for all assets, including those assets that were previously fully written down.
- For revaluation decrements – accumulated depreciation remains unchanged post revaluation other than where it is adjusted downwards in instances where the valuation results in a decrement to cost and the current accumulated depreciation recorded exceeds this cost. A downward adjustment to accumulated depreciation is then made to equal the cost of the asset and as a result partially depreciated assets are now fully written down.

This is not in accordance with either approach mandated by the standard and as a result book values and useful lives are incorrectly stated.

Per discussions it was determined that a decision was made not to proportionately adjust the accumulated depreciation for buildings as the revaluation in FY2016/17 was a desktop exercise. Given that the movement in fair values of assets was considered immaterial, it was determined not to adjust accumulated depreciation and only adjust the gross replacement cost instead.

However, for other assets, accumulated depreciation should have been recalculated and adjusted accordingly. Management should consider the need to quantify the difference to determine the impact on book values for FY2016/17 and future depreciation expense.

Depreciation - methods and useful lives

Summary of key accounting requirements

- Subsequent to initial recognition, property, plant and equipment is depreciated on a systematic basis over its useful life.
- An entity allocates the amount initially recognised in respect of an item of PPE to its significant parts and depreciates separately each part.
- A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. Methods include the straight-line method, the diminishing-balance (or reducing-balance) method and the sum-of-the-units (or units-of-production) method. The method of depreciation reflects the pattern in which the benefits associated with the asset are consumed.
- Depreciation of an asset begins when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.
- The depreciation charge for each period is recognised as an expense in P&L, unless it is included in the carrying amount of another asset.
- Useful life is either

a) the period over which an asset is expected to be available for use by an entity or

b) the number of production or similar units expected to be obtained from the asset by an entity.

- The useful life of an asset and the depreciation method applied is reviewed as a minimum at each annual reporting date. Any changes shall be accounted for as a change in an accounting estimate.

[AASB 116.6, 43-51, 55, 60-62]

Although there is no one best method of depreciation that should be applied across all assets, the method should be cost effective and must meet the requirements of AASB 116 Property, Plant and Equipment.

Ultimately, the method used must materially be based on relevant factors that provide sufficient and appropriate evidence for determining the level of remaining service potential (useful life) and how it is consumed taking into account utilisation, wear and tear, obsolescence, legal and other limits.

The pattern of consumption of future economic benefits may take various forms and hence require a different method of depreciation. There is a risk of material misstatement if erroneous assumptions are used when determining the pattern of consumption of future economic benefits.

Key findings

- The methodologies adopted by the City around depreciation (methods and useful lives) are in accordance with accounting standards.
- It is noted that decisions to dispose of assets before the end of their useful lives often requires significant write-offs of the carrying value of some assets. For such assets, a constant pattern of early disposal may require a revision to useful life estimates.
- Differences in depreciation expense calculated for buildings was identified due to an incorrect commissioning date being applied. We understand this error isolated due the componentisation of buildings as at 1 July 2016.
- Inventory of assets may not be complete. It is our understanding that the City had recently undergone a process to ensure all assets are brought to account and that the fixed asset register is complete and accurate.

Recommendations

- The City to consider implementing a consistent approach whereby useful lives are reviewed and updated based on historical information.
- We recommend reviewing any differences identified to assess their significance and if necessary, undertake further analysis to determine the amount of any potential adjustments required. In addition, management should implement appropriate review procedures to ensure that any errors in depreciation calculations are identified before processing.

Depreciation - methods and useful lives (cont.)

Analysis

KPMG performed a review of the City's depreciation methods and useful lives for buildings, transport and drainage assets. Such review procedures included the following:

- *Consideration of the City's compliance with accounting standards and other applicable accounting requirements*

  The methodology adopted by the City is in accordance with accounting standards. Considerations included:

AASB requirements:	
Method matches the pattern of consumption?	✔
Method depreciates the depreciable amount only? (residual value)	✔
Method depreciates over the useful life in a systematic way?	✔
Method allows for obsolescence?	✔
Method calculates depreciation separately for significant components?	✔

  Refer below for work performed over the above.

- *Consideration of the appropriateness of the methodology used for depreciation and whether it reflects the expected pattern of consumption of the future economic benefits*

  The pattern of consumption of future economic benefits may take various forms and hence require a different method of depreciation. The City adopts the straight-line method which assumes consumption is constant over the useful life of the asset, rather than an alternative method where consumption is either greater in the early years or perhaps increases as the asset approaches the end of its useful life.

  We understand that analysis has been performed by the City regarding the use of alternate methods of depreciation by reviewing historical rates of consumption of economic benefits of assets and obsolescence of assets. However, it has been evidenced that deterioration is erratic for similar assets due to the many parameters that can affect assumptions around the consumption of economic benefits.

  As such, no decision has been made to use a method other than the straight-line method. The City considers there is no material benefit to recommend an depreciation method other than what is currently adopted.

  It is also noted, from a review of the financial statements of 15 other local governments, that all 15 local governments use the straight-line method of depreciation.

- *An assessment of the methodology used to determine useful lives and whether useful lives of assets are in accordance with the City's accounting policies*

  Unless a unique asset, for new assets a depreciation rate is calculated for each component based on the useful life (in years) of the asset as documented in the Expected Life and Costs for all Assets document. Useful lives of assets are subsequently updated when revaluation adjustments are processed based on Condition and Performance Assessments. Such assessments consider the remaining service potential of the assets based on condition and obsolescence. There are generally no concerns around obsolescence of assets as assets are well maintained and are generally kept in good condition.

  KPMG agreed the useful lives for a sample of assets selected for testing to the City's accounting policies. No exceptions noted.

  The requirements of the accounting standard relating to depreciation requires that the method used should depreciate over the asset's useful life, where useful life of an asset is defined in terms of the asset's expected utility to the City. An AASB decision in May 2015 clarified that 'where an entity has control of an asset and intends to continue to consume the future economic benefits embodied in an asset through use, the asset cannot be regarded as having reached the end of its useful life to the entity'. Therefore the end of the useful life of an asset is the point in time when the entity relinquishes control of the asset.

  The City has identified various assets that often require replacement while still in a useable condition necessitating a write-off of the carrying value of the existing asset once the decision has been made to dispose of the asset in advance of the end of its useful life.

Depreciation - methods and useful lives (cont.)

Analysis (cont.)

For such assets, the identification of a constant pattern of early disposal may require an adjustment to shorten the useful lives of such assets due to an decrease in the period over which the asset is expected to be available to the City. Currently a consistent approach is not followed whereby the City updates useful life estimates based on historical data of assets that have been disposed of in advance of the end of their useful lives.

- *Consideration of whether the City should engage independent third parties to peer review useful life estimates and best practice around peer reviews*

  KPMG considers that an independent review by a third party is unlikely to derive any significant benefits. The City's engineers and asset teams have significant expertise in this area and understand the local environment well. A peer review is unlikely to add significant value, however, potentially a periodic review (for example, every 3 years) should ensure that the City is not moving outside generally accepted ranges.

- *Re-performing depreciation calculations*

  All assets, other than the road formation, are depreciated. For buildings, transport and drainage assets, depreciation is automatically calculated by TechOne on a monthly basis over the asset's useful life using the straight line method of depreciation. KPMG re-performed the depreciation calculations for FY2016//17 for a sample of asset components selected for each Bridges and Underpasses, Buildings, Paths, Roads and Car Parks, Drain Pipes and Drain Pits. The following was noted:

  I. Depreciation rates adopted for assets was in accordance with the City of Joondalup's accounting policy and depreciation is calculated on all assets with limited useful lives.

  II. Depreciation is calculated separately for all asset components.

  III. Differences in depreciation expense calculated for all buildings tested was identified. This difference was due the City incorrectly applying a commissioning date of 31 July 2016 instead of 30 June 2016 to new asset building components. Management should consider the need to quantify the impact on depreciation expense and asset book values for FY2016/17.

  I. Various bridge assets of the City's were brought into inventory for the first time after being identified during the revaluation process. The asset's cost is revalued to GRV, and an amount was calculated and allocated to accumulated depreciation at period end.

- *Benchmarking procedures and analysis on useful lives to determine best practice*

  Refer to Benchmarking analysis section of this report.

Componentisation & residual values

Summary of key accounting requirements

- If an item of property, plant and equipment comprises individual components for which different depreciation methods or rates are appropriate, then each component is depreciated separately.
- An item of property, plant and equipment is separated into parts (components) when those parts are significant in relation to the total cost of the item.
- Component accounting is mandatory if it would be applicable. However, this does not mean that an entity should split its assets into an infinite number of components if the effect on the financial statements would be immaterial.
- Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.
- Residual value is an estimate of the amount that an entity could receive from disposal of the asset at the reporting date if the asset were already of the age and in the condition that it will be in when the entity expects to dispose of it.
- The residual value of an asset is reviewed as a minimum at each annual reporting date and changes are accounted for as a change in accounting estimate.
- In many cases, the residual value will be insignificant or zero because the asset will be scrapped at the end of its useful life.

[AASB 116.6, 43-47, 51, 53]

Depreciating only the depreciable amount requires a determination of the residual value. Assumptions around residual values affect depreciation expense. Similarly, there is a risk that depreciation expense may be incorrectly calculated if assets are not correctly componentised.

Componentisation requires that assets comprised of a number of significant parts which have a different value and exhibit different useful lives or depreciation methods are to be depreciated separately.

The AASB's clarification regarding the definition of Residual Value in May 2015 may require entities to adopt a more detailed level of componentisation. Failure to componentise (separately identifying the short-life and long-life parts) to the required level may lead to overstatement of depreciation.

Key findings

- It is considered appropriate that the City adopts nil residual values. This is in line with the requirements of accounting standards.
- Based on the work KPMG performed it appears assets are appropriately componentised and any further componentisation into short-life and long-life components is unlikely to have a material effect.

Recommendations

- No recommendations are noted.

Componentisation and residual values (cont.)

Analysis

KPMG have considered the appropriateness of the City's componentisation accounting and also of adopting residual values for buildings, transport and drainage assets. Such review procedures included the following:

- *Consideration of the appropriateness of adopting residual values based on how assets are managed in accordance with accounting standards, including recommendations around an appropriate accounting policy*

  The City has adopted nil residual values in accordance with accounting standards as generally assets are not sold. This is considered appropriate.

  In June 2014, the Board received a submission requesting the AASB clarify the definition of residual value in AASB 116 *Property, Plant and Equipment*. Specifically, whether the intention of AASB 116, through the definition of residual value, is to limit the recognition of residual values to instances where an entity expects to obtain consideration from the sale of an asset at the end of its useful life. Key points from the AASB's decision were that the residual value was the amount received upon its disposal, where disposal is the point when the control over the asset is relinquished. As a consequence the residual value for the majority of the City's assets would be nil.

  Rather, for assets which comprised components subject to regular renewal, the AASB indicated that such components need to be split into a short-life part and a long-life part with each part separately depreciated. The short-life and long-life components are not required to be physically identifiable. These assets are commonly referred to as recyclable assets whose useful life and service potential are regularly extended through ongoing maintenance, renewal and/or replacement of parts. These types of assets typically are required to provide a certain level of service to the community where components are replaced or renewed at regular intervals in order to continue delivering an appropriate level of service.

- *Consideration of the appropriateness of componentisation accounting in accordance with accounting standards including consideration of judgements made as to what constitutes a significant component*

  Following the AASB's clarification componentisation is required specifically around those assets subject to regular renewal (recyclable assets) with the long-life asset representing the recyclable component and the short-life asset representing the non-recyclable component.

  Based on discussions it was determined that for financial reporting purposes, the City already componentises its buildings, transport and drainage assets into various short-life and long-life components. Each are depreciated over their respective useful life. For example, a building is componentised as follows:

Component	Description
Structure	Walls (internal and external), columns, floor joists.
Roof	Purlins, joists, frame, covered ways, gutters, roof tiles, colorbond sheeting.
Services (Short life)	Reverse cycle air-conditioning systems, lights, light switches, power outlets, hot water systems, toilets cisterns, lifts, switchboards.
Services (Long life)	Plumbing and gas pipes, electrical cables, air-condition ducting.
Fixtures and Fittings	Floor coverings, ceiling, doors, windows, partitions, signage, kitchen benchtops, taps, skirting, architraves.

  Transport and drainage assets are similarly componentised. The level of componentisation adopted by the City is in line with asset management plans and it is at this level that depreciation is calculated and revaluations are performed. Due consideration has been given to the cost/benefit of calculating depreciation and producing valuation figures for relatively low value parts. Based on discussions, it is considered the level of componentisation adopted by the City is the lowest level at which the associated cost/benefit is warranted and practicable.

  It is also at this level that KPMG recalculated the depreciation and revaluation adjustments for the sample of assets selected for testing.

Benchmarking Analysis

Benchmarking analysis

KPMG conducted a benchmarking analysis by collecting and analysing asset and depreciation expense numbers, including useful lives adopted, extracted from the FY2016/17 annual reports of 15 Local Government Areas (LGAs) with the objective of determining best practice and providing some key insights.

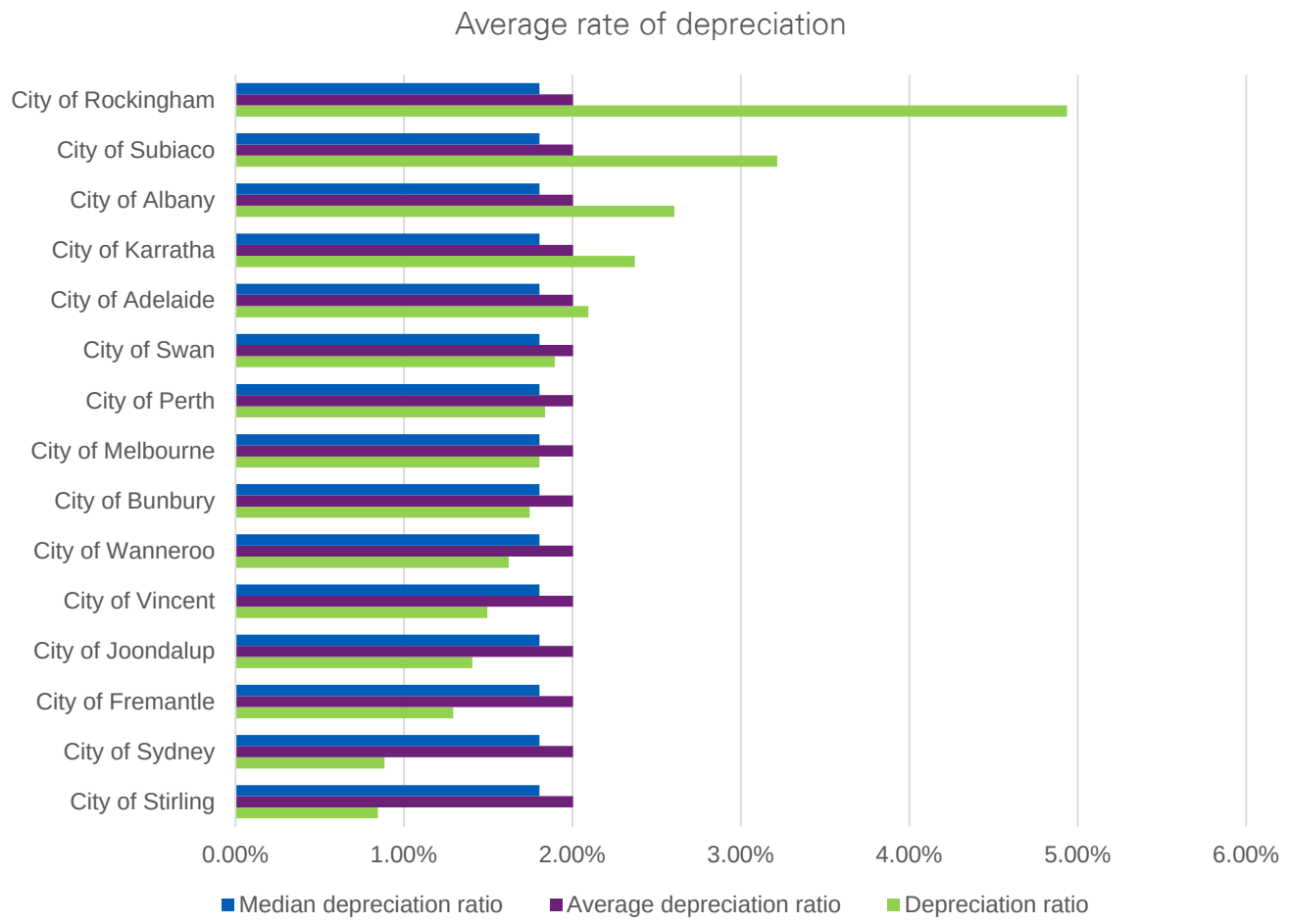
Various benchmark analysis was performed using the total cost of assets, both PPE and infrastructure assets, and total depreciation expense.

The analysis was further broken down by asset class for Buildings, Roads, Footpaths, Bridges and Underpasses and Drainage.

Depreciation to fixed assets ratio

The depreciation to fixed assets ratio (average rate of depreciation) compares the total amount of depreciation expense for the year as a percentage of the total value of the total cost of fixed assets (both PPE and Infrastructure Assets).

If the rate increases over time it may indicate issues with the effectiveness of the asset management framework.

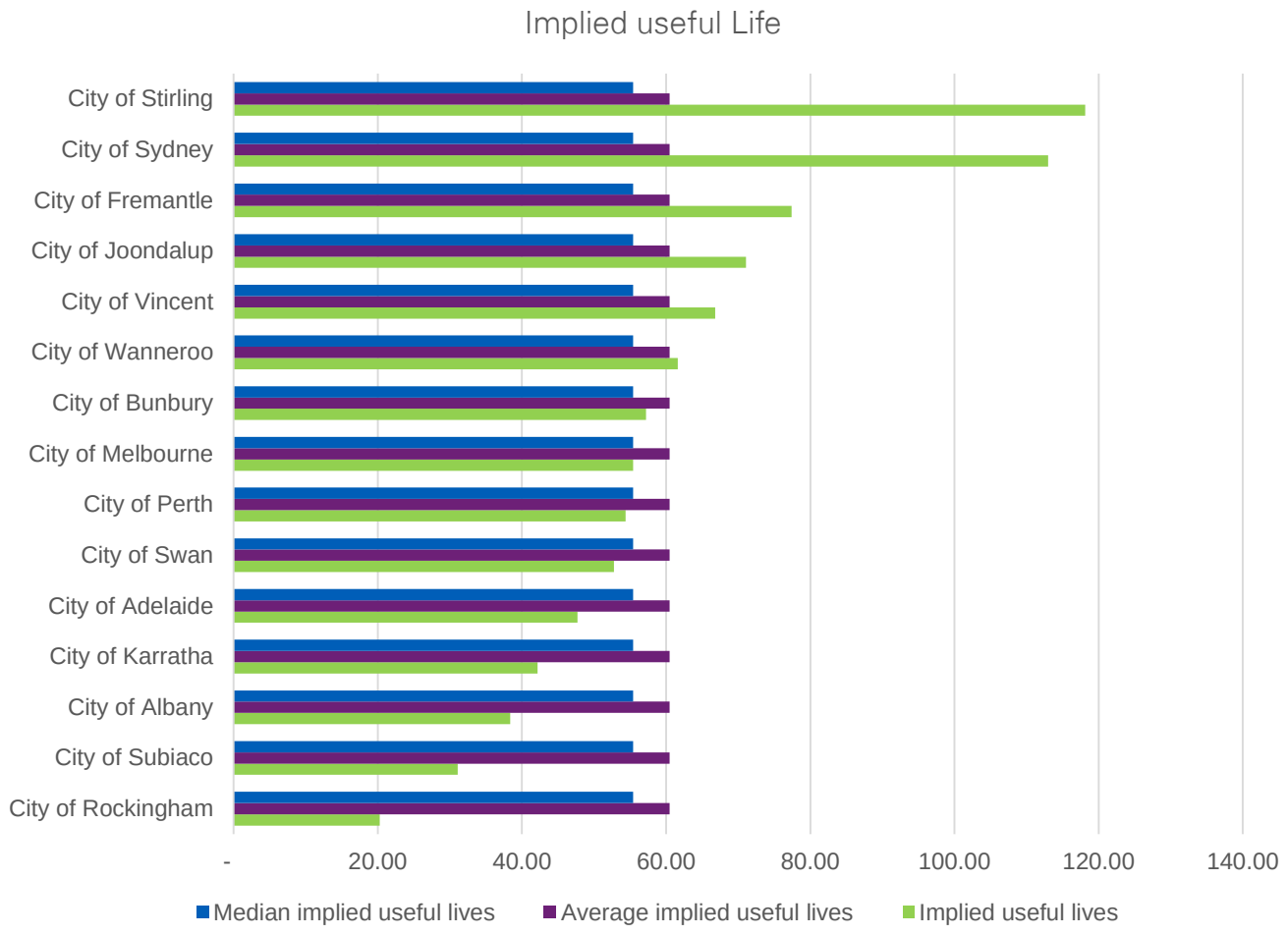


When benchmarking against similar entities, the City's average rate of depreciation for all assets is lower than the combined average of all 15 LGA's and also lower than the median.

Benchmarking analysis (cont.)

Implied useful life

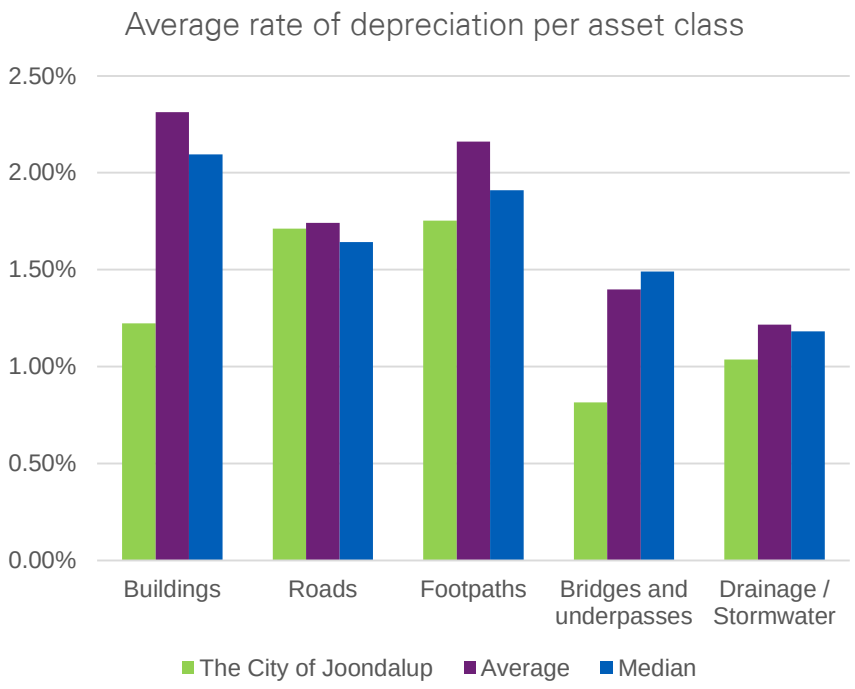
The implied useful lives of assets was calculated by dividing the total cost of fixed assets (both PPE and Infrastructure Assets) over the total depreciation expense for year.

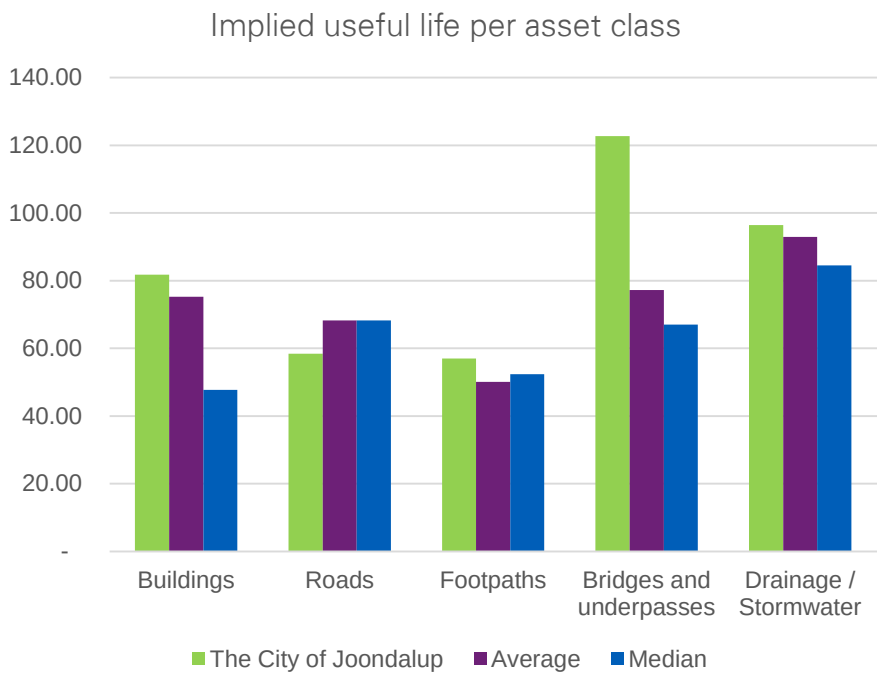


When benchmarking against similar entities, the implied useful lives of all its assets is higher than the combined average of all 15 LGA's and also higher than the median.

Benchmarking analysis (cont.)

The average rate of depreciation and implied useful life was calculated by asset class for Buildings, Roads, Footpaths, Bridges and Underpasses, and Drainage. These ratios were compared against similar entities who disclose the same asset classes in their annual report. Care should be taken when drawing conclusions from analysing the results below due to the lack of transparency around the different classes of assets disclosed in the annual reports of the other LGAs. Refer to the table below for the number of LGA's included in the calculation of the average for both ratios.





Buildings	Represents the average of 14 LGAs
Roads	Represents the average of 12 LGAs
Footpaths	Represents the average of 12 LGAs
Bridges & Underpasses	Represents the average of 5 LGAs
Drainage	Represents the average of 13 LGAs

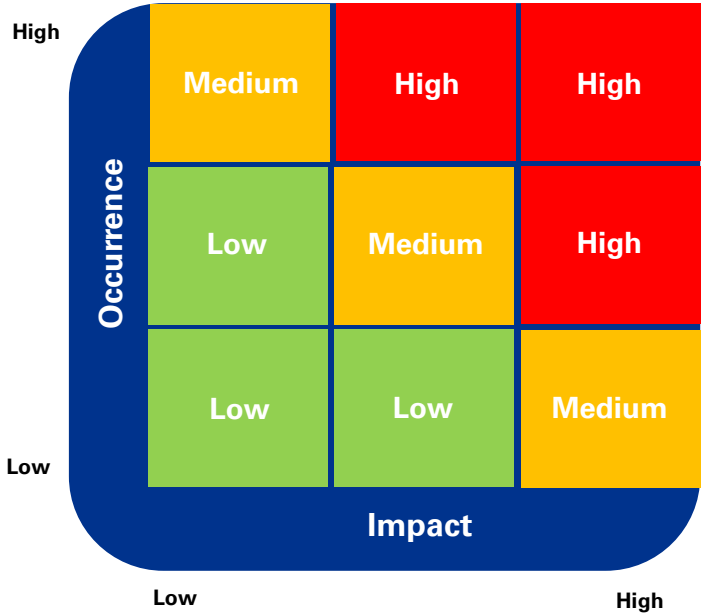
Current State Analysis

Acquire to Retire Current State Review

Key stakeholders that have input into each of the steps in the Acquire to Retire process were identified and engaged to assist in a workshop to map the current state of process and to identify pain points.

Process documentation is a key document which serves as a roadmap to help in the identification of the current state of a process and also helps you to know how to improve on it. The pain points have been categorised based on occurrence and impact using the below Pain Point Assessment Matrix based on input from key stakeholders during the workshop session and validated with senior staff.

Pain Point Assessment Matrix



Occurrence

High	Pain Point occurs more than 65% of the time during the process timeline
Medium	Pain Point occurs more than 30% but less than 65% of the time during the process timeline
Low	Pain Point occurs less than 30% of the time during the process timeline

Impact

High	Pain Point results in complete failure of the process (critical impact).
Medium	Pain Point has manageable (tolerable impact) to material impact on the process or customer.
Low	Pain Point has little to no material impact on the process or customer.

Pain Points

Pain Point Ref #	Key phase	Pain Point	Pain Point Detail	Current Priority Rating
PP.01	Process Governance	Lack of process documentation across business unit (Finance & Asset Management)	Process documentation across the various fixed asset processes is either: • not available; • not adequate; and/or • is not standardised.	H
PP.02	Process Governance	Inconsistency of control over fixed asset processes	For some asset classes, such as buildings, a single business unit controls the end-to-end process around the asset. Whereas for other asset classes, 3 or more business units are involved in the process leading to a lack of transparency and allowing for opportunities for control gaps and errors.	M
PP.03	Capital Planning	No standardised process for review of depreciation budget	There is no formal process to review and make updates to depreciation estimates after initial budgeting for depreciation. In addition, no collective review is performed, rather reviews of the budget that occur are done in isolation of other key business units.	H
PP.04	Capital Planning	When budgeting for depreciation, asset revaluations are not yet complete	Estimates for budgeting purposes are finalised by January each year based on asset carrying values at the time of preparing the budget and various other assumptions. Adjustments for revaluations and additional inventory items, completed subsequent to the budget, often have a significant impact on these estimates.	H
PP.05	Capital Planning / Asset Revaluation	Lack of staff resources	Discussions around bringing forward the timing of revaluations so that revaluation adjustments are incorporated into budgeting estimates, highlighted the lack of staff resources for this to occur on a more timely basis.	H
PP.06	Capital Planning / Asset Retirement	No process for budgeting for asset impairments/write-offs	No formal process and insufficient information available around capital works programs and replacements of assets to accurately forecast asset impairments/write-offs as part of the budgeting process. This information only becomes available at a later date.	H
PP.07	Asset Record Creation	Capitalisation of some of the costs of assets is delayed due to contractor defects liability periods	Projects often remain 'open' even though practically complete due to defects liability periods where money is held over to pay consultants to remedy defects. This could delay full capitalisation of assets into the fixed asset register and depreciation of the asset.	L

Pain Points

Pain Point Ref #	Key phase	Pain Point	Pain Point Detail	Current Priority Rating
PP.08	Asset Record Creation	Incompleteness of asset inventory	Completeness of asset inventory is an issue as the City continues to identify certain assets during the revaluation or condition assessment process.	L
PP.09	Asset Depreciation	Historical useful lives not being utilised for determining future useful lives for all asset classes	A consistent approach is not followed for the use of historical data to influence useful lives (depreciation rates) adopted for similar fixed assets going forward.	L
PP.10	Asset Depreciation	Lack of a consistent approach for updating useful lives of assets following condition and performance assessments	Lack of a formalised consistent approach regarding revisions to useful lives of assets after condition and/or performance assessments are completed.	M

Improvement opportunities

For those pain points rated Red or Amber, identified below are various short term actions or longer term initiatives that either Finance or the wider business units should consider implementing to improve the existing processes.

Strategic

- Redesign the end to end asset acquire to retire process to better support business and finance needs.
- Realign businesses to allow a single business unit to manage each asset class

Invest effort

- Adequately document all fixed asset processes with clear governance, process documentation and RACI.
- Investigate the root cause for the delay of the valuation process and consider opportunities to align timetables for valuation and budgeting purposes.
- Develop and implement various Exception Reports to help identify errors or inaccurate data (e.g. assets whose value has increased/ decreased by more than x%)

Just do it

- Clarify roles, responsibilities and accountabilities for performing monthly processes.
- Develop and implement standard validation checks and reviews across teams to reduce errors or incomplete or inaccurate data.
- Develop clear guidance and training to ensure accountabilities and requirements are understood, and if necessary, establish KPIs to reinforce accountabilities.

Quick wins

- Improve communication across Finance and Asset Management Teams.
- Implement monthly meetings business units to improve alignment over fixed asset processes.

Finance Maturity Assessment

Key stakeholders engaged in the workshop were asked to assess the current maturity of the finance function around fixed assets by using a rating scale from 1 to 5. Participants were asked to consider their preferred future state for the City of Joondalup. Responses were aggregated and are presented below.

	Foundational	Established	Leading
Core Activities	• Significant focus on core processing such as transaction capture and month-end close • Limited awareness of organizational strategy	• Moderate focus on reporting and analysis • Degrees of alignment with organisational strategy	• Significant focus on reporting and analysis • Finance function fully aligned with organisational strategies • Manage outsourced functions
Accuracy Levels	• Significant adjustments requests from internal users and audit results • Financial restatements required in some cases	• Some post-close adjustments required • Accuracy levels are internally considered to be "close enough"	• Limited post-close adjustments required • Financial results considered accurate by internal users • Strong history of financial reporting accuracy
Reporting Content	• Offline/Manual processes utilised to generate management and internal reporting	• Limited use of external systems to produce internal reporting	• Systems and processes fully support internal reporting needs
Organisation Structure	• Limited training and knowledge transfer • Decentralised and autonomous finance and accounting operations • Limited organisational standards, policies and procedures	• Centralised finance and accounting operations • Degrees of process standardisation • Informal processing expectations	• Shared Service center or Business Process Outsourcing operations • Formalised Service Level Agreements and expectations • Standardised and optimised processes
Technology	• Numerous disparate systems containing financial data • Software packages may not be current or fully supported • Significant reliance on spreadsheets for data collection, manual calculation and manipulation, and reporting	• Mixture of incorporated and non-incorporated systems • Potentially leading software packages providing base functionality • Version control leveraged for spreadsheet processing and analysis	• Fully incorporated financial system(s) • Fully leveraged leading ERP capabilities • Utilisation of enabling technologies such as workflow, reconciliation management applications, close tracking systems, document management systems and multi-dimensional analysis tools

Key:

- 2018 Average
- Future State Average

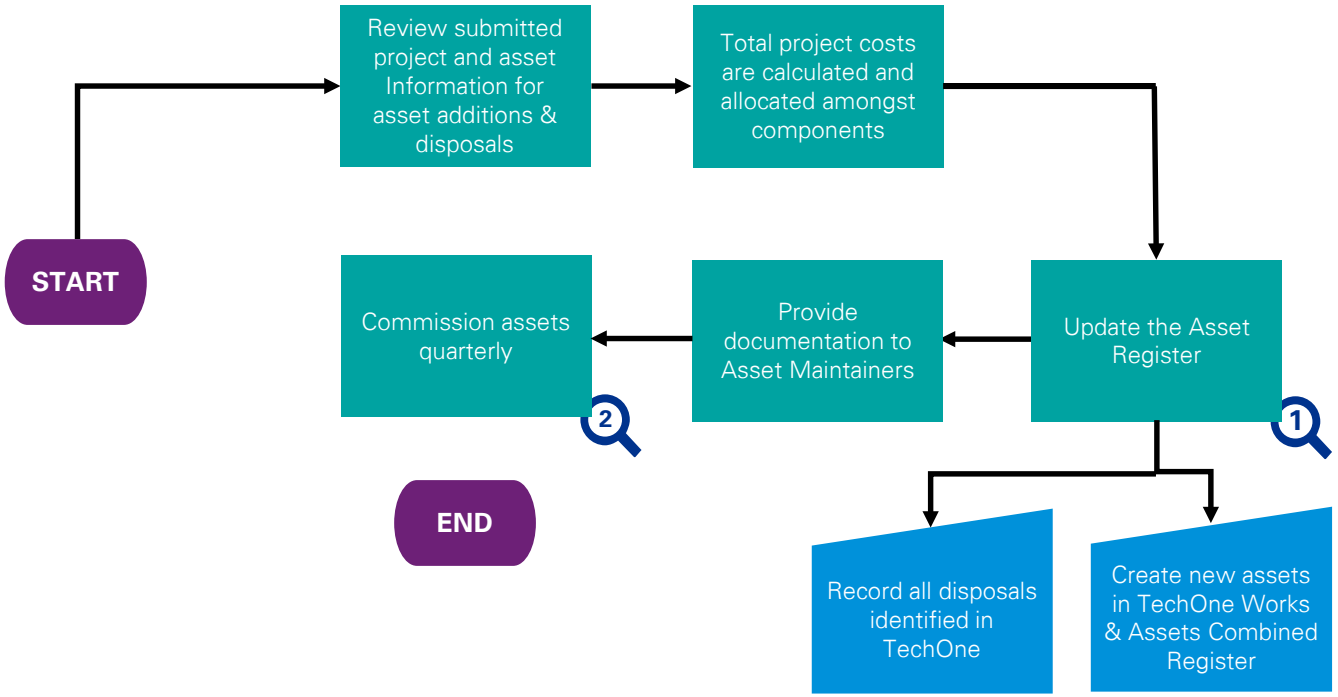
Better Practice

* Rating scale from 1 to 5

Level 3 Process Map

Process – Asset creation

KPMG discussed and documented the asset creation process with management. The current process is mapped out below. Recommendations to address the pain points identified are summarised on page 13.



Key

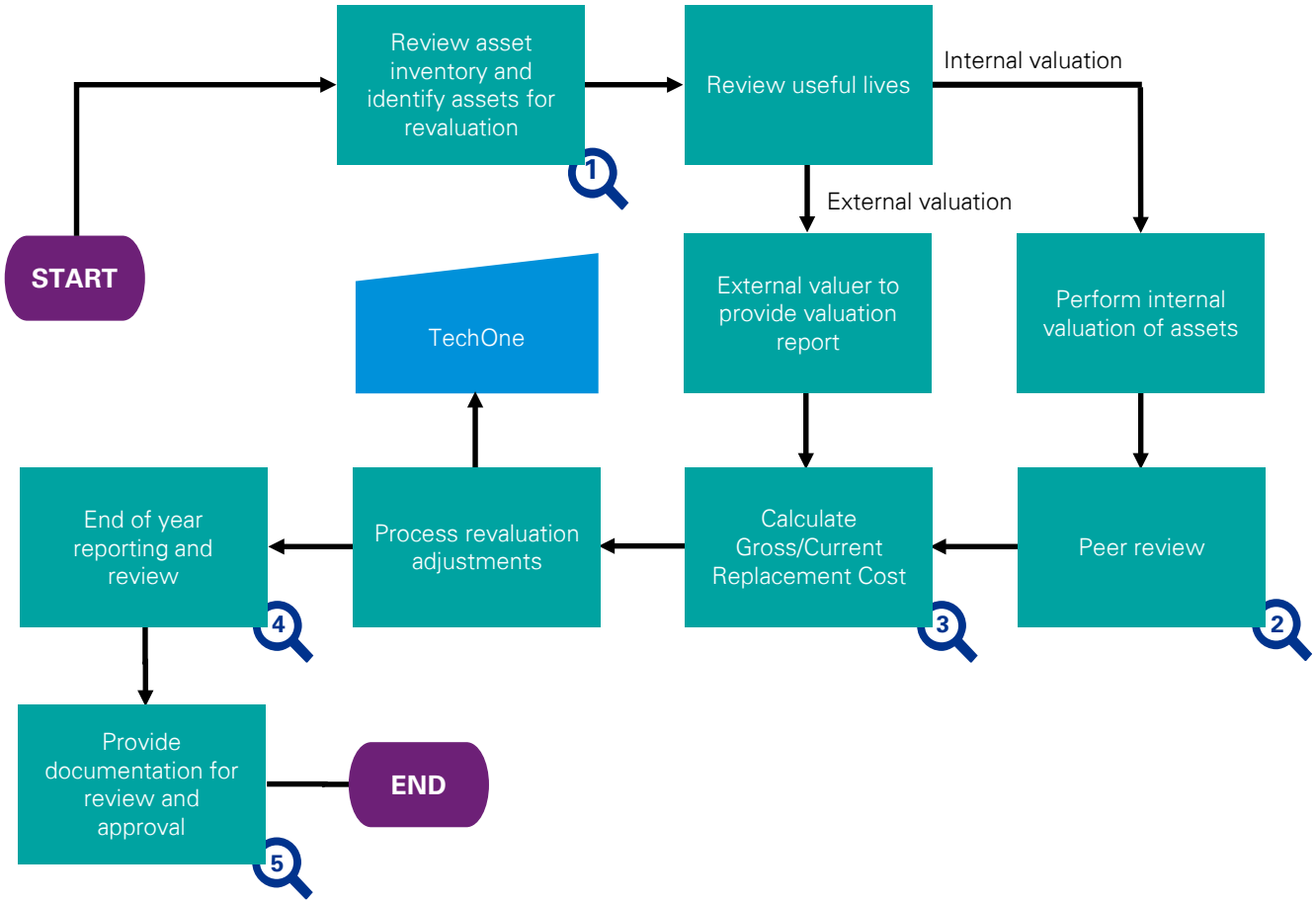
Controls identified

1. The IAMT review various reports on a monthly basis regarding the status of projects requiring capitalisation.
2. Various reasonableness checks are performed by the IAMT prior to commissioning of assets.

Level 3 Process Map

Process – Revaluation

KPMG discussed and documented the revaluation process with management. The current process is mapped out below. Recommendations to address the pain points identified are summarised on page 13.



Key

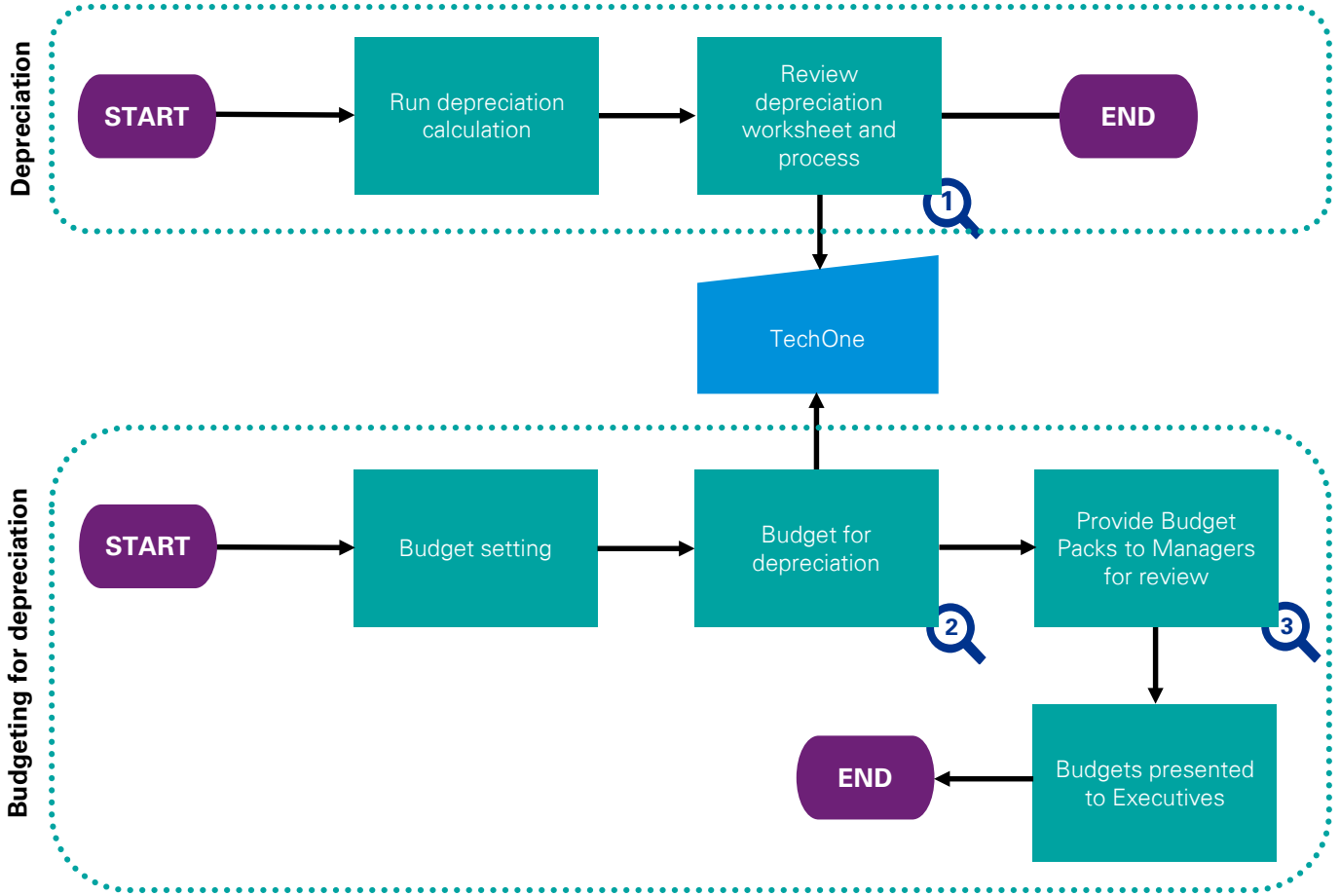
Controls identified

1. The IAMT review asset inventories for completeness prior to the revaluation process.
2. A peer review is performed on the appropriateness of the methodology adopted and assumptions used in the calculation of unit rates and useful lives.
3. The calculation to adjust the assets' cost and accumulated depreciation is reviewed for accuracy and reasonableness by the Finance Team before processing.
4. End of Year Asset Valuation Reports are reviewed by the IAMT.
5. Final reports are reviewed by the Finance Team and subsequently by the Director.

Level 3 Process Map

Process – Depreciation and budgeting for depreciation

KPMG discussed and documented the depreciation process with management, including the process around budgeting for depreciation. The current process is mapped out below. Recommendations to address the pain points identified are summarised on page 13.



Key

Controls identified

1. Both the IAMT and Finance Team perform a review of the depreciation calculation for accuracy before processing.
2. Budget Packs prepared by the Management Accounting Team are reviewed by the appropriate business units.
3. Budgets are reviewed and approved by the Executives.

RACI matrix - future state

The below RACI matrix has been used to identify roles and responsibilities representing best practice (future state). The processes/activities and the roles and responsibilities have been identified by City of Joondalup management as those they want to adopt in the future state.

Task	EXECUTIVE			FINANCE						ASSET MANAGEMENT					OTHER STAKEHOLDERS			
	Director Corporate Services	Director Infrastructure Services	Chief Executive Officer	Manager Financial Services	Senior Financial Analyst	Senior Financial Accountant	Financial Accountant	Senior Management Accountant	Management Accountant	Manager Asset Management (operational)	Coordinator Strat. Infra. Asset Mgmt	Senior Infrastructure Systems Officer	Asset Systems Officer	Infrastructure Systems Officer	Asset Managers (Business Unit Mgrs)	Asset maintainers (Operational)	Project Managers (Capital)	Sub-Unit (Team) Coordinators
1. REVALUATION																		
01 Schedule Asset Revaluations and Organise Resources	I	I		C		C				C	A/R	I	I	I	I			
02a Review Expected Useful Lives	I	I		C	I	C					A	R	S	S	C	C	C	C
02b Review Remaining Useful Lives	I	I		C	I	C					A	R	S	S	C	C	C	C
02c Determine SRCs to be applied				C	I	C					A	R	S	S	C	C	C	C
03a Perform Internal Valuation of Assets				I		C					A	R	S	S	I			
03b Arrange External Valuer to provide Valuation Report				I							A/R	S	S	S	I			
04 Arrange External Peer Review				I		I					A	R	S	S	C	C		
05 Calculate Gross/Current Replacement Cost for EOFY Inventory					I	C					A	R			I			
06 Process Revaluation Adjustments (External and Internal)				C		A					A	R	S		I			
07 Provide End of Year Reporting Documentation		I		C		A					A	R	S		I			
08 Review and Approve End of Year Reporting Documentation for sign off		I		A		R					I	I			I			

R	The person who is responsible for producing the deliverable
A	The person who is accountable for the deliverable
C	The person/s to be consulted before a decision can be made
I	The person/s must be informed of any decision that has been made
S	The person/s who provide support to those responsible

RACI matrix - future state (cont.)

The below RACI matrix has been used to identify roles and responsibilities representing best practice (future state). The processes/activities and the roles and responsibilities have been identified by City of Joondalup management as those they want to adopt in the future state.

Task	Director Corporate Services	Director Infrastructure Services	Chief Executive Officer	Manager Financial Services	Senior Financial Analyst	Senior Financial Accountant	Financial Accountant	Senior Management Accountant	Management Accountant	Manager Asset Management (operational)	Coordinator Strat. Infra. Asset Mgmt	Senior Infrastructure Systems Officer	Asset Systems Officer	Infrastructure Systems Officer	Asset Managers (Business Unit Mgrs)	Asset maintainers (Operational)	Project Managers (Capital)	Sub-Unit (Team) Coordinators
	EXECUTIVE			FINANCE						ASSET MANAGEMENT					OTHER STAKEHOLDERS			
2. ASSET CREATION / DISPOSAL & AMENDMENTS																		
01 Review Submitted Project and Asset Information for Asset Inventory changes										A	R	R	R				C	
02 Total Project Costs are calculated and allocated amongst assets										A	R	R	R				C	
03 Update the Asset Register for New, Existing & Disposed Assets (Asset not commissioned as yet)										A	R	R	R			C	C	
04 Create/Update Asset Book with EUL and Depreciation Parameters										A	R	R	R			C	C	
05 Provide Documentation to Asset Maintainers										A	R	R	R			I		
06 Commission and Dispose Assets						C	C			A	R	S			I	I		
07 Provide Write Off and Non-Capital Expenditure Documentation						I	I			A	R	S	S		C		C	
08 Process Worksheet within TechOne for Non-Capital to Operating Expenditure Transfer				I		A/R	R			C	C				I			
3. DEPRECIATION																		
01 Run Depreciation Calculation										A	R	S			I			
02 Review Depreciation Transactions and Process				I		A/R	R			I	I				I			
4. BUDGETING FOR DEPRECIATION																		
02a Calculate inventory based expected Depreciation for Infrastructure Assets								I	I	A	R	S						
02b Estimate changes to expected Depreciation for Infrastructure Assets based on known projects to be completed, land developments, asset handovers etc					I			I	I	A	R	S			C	C	C	C
03 Provide Budget Packs to Managers for completion				A				R							I			
04 Complete budget packs including Infrastructure Asset Depreciation, Write-Offs & Impairments								I	I	C	C				A	C	C	R
05 Budgets presented to Executive	C	C	C	C											A/R			

Contact us

Michael Day
Director
+ 61 (8) 9263 7409
mday1@kpmg.com.au

Joanne van Biljon
Associate Director
+ 61 (8) 9263 7524
jvanbiljon@kpmg.com.au

kpmg.com.au