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INQUIRY INTO THE CITY OF PERTH

PUBLIC HEARING - DAY 123

MONDAY, 7 OCTOBER 2019

INQUIRY PANEL:

COMMISSIONER ANTHONY (TONY) POWER

COUNSEL ASSISTING:

MR PHILIP URQUHART

COUNSEL APPEARING:

MR COLBY TREASURE (MR ROBERT MIANICH)

.07/10/2019

HEARING COMMENCED AT 10.03 AM:

5 COMMISSIONER: I will begin with an Acknowledgment of Country. The Inquiry into the City of Perth acknowledges the traditional custodians of the land on which it is conducting this hearing, the Whadjuk people of the Noongar Nation and their Elders past, present and future. The Inquiry acknowledges and respects their continuing culture and the contribution they make, and will continue to make, to the life of this City and this region.

10 Mr Urquhart.

15 MR URQUHART: Thank you very much, Commissioner. We are now in the final block of public hearings. As Mr Beetham foreshadowed at the start of block C, this will be a short block by comparison to the first three. Block D will feature two key themes. The first will be the financial management at the City of Perth, particularly, but not confined to, the timeframe of the Inquiry's Terms of Reference, that is, from 1 October 2015 to 1 March 2018. The second will concern the future and whether any lessons can be learnt from how the City functioned in the years prior to its suspension.

20 With respect to finance, we will hear first from John Nicolaou from ACIL Allen Consulting, an economics and policy consultancy firm. Mr Nicolaou will provide the Inquiry with a summary of his findings on the City of Perth's finances from the financial years 2011/2012 to 2017/2018, and his assessment as to the degree the
25 City had in place good strategic and financial practices to ensure sound financial management of the City and its commercial operations. In short, those findings have identified a number of shortcomings that can be traced to, amongst other factors, governance and KPIs which had limited value.

30 After Mr Nicolaou, we will hear from Robert Mianich, the City's Director of Corporate Services during the period of the Inquiry's Terms of Reference. In fact, he was the longest-serving Director at the City when its Council was suspended, having held that position since 2005. Amongst other things, Mr Mianich was responsible for the financial management of the City. He will be examined about a
35 number of matters that were brought to his attention in a letter from the City's CEO in March 2019, which questioned some aspects of his performance.

40 Mr Mianich will be followed by Martin Mileham, the CEO or Acting CEO of the City for much of the period of Inquiry's Terms of Reference. He, as the Chief Executive, had ultimate responsibility for the City's finances. Once Mr Mianich and Mr Mileham's evidence is completed, we will hear from Murray Jorgensen, the City's present CEO. Mr Jorgensen will give evidence about the state of the City's finances when he commenced as CEO, and its present state. He will also give
45 evidence as to the current regime's vision for the future and I anticipate he will be able to provide the Inquiry with suggestions for possible areas of reform, not only for the City of Perth but for all Local Governments.

5 The Inquiry's final public witness will be Mr Andrew Hammond, one of the current Commissioners of the City. Commissioner Hammond will speak as to what has been happening at the City since the suspension of the Council in March of 2018, and what the future will hold for a City that has been mired in more than its fair share of controversies for several years prior to the Council's suspension.

10 Commissioner, that is all I wish to say by way of opening remarks. I will make some concluding remarks, most likely on Wednesday afternoon of this week, regarding all the matters that have been the subject of in excess of 120 days of private and public hearings, involving the taking of evidence from over 100 witnesses. Sir, before I call Mr Nicolaou, I just might need to have a short adjournment whilst some arrangements are made.

15 COMMISSIONER: Thank you very much, Mr Urquhart. Those submissions are very helpful. I will adjourn the Inquiry shortly to allow those arrangements to be made.

(Short adjournment).

20 COMMISSIONER: Yes, Mr Urquhart.

25 MR URQUHART: Thank you, Commissioner. The first and only witness for today will be John Andrew Nicolaou and Mr Nicolaou is already in the back of the hearing room.

COMMISSIONER: Thank you very much. Mr Nicolaou, would you please come forward and take a seat in the witness box to my left. Thank you. Mr Nicolaou, will you take an oath or make an affirmation?

30 MR NICOLAOU: I will take an oath.

COMMISSIONER: Thank you. Madam Associate.

35 **MR John Andrew NICOLAOU, sworn:**

COMMISSIONER: Thank you. I will hear applications now.

40 MR TREASURE: Commissioner, Mr Treasure, and I seek leave to appear and represent Mr Robert Mianich pursuant to the application that was filed with a supporting affidavit from Belinda Randall filed on 4 October 2019.

COMMISSIONER: Thank you. Is there any objection, Mr Urquhart?

45 MR URQUHART: No, there's no objection, sir.

COMMISSIONER: Thank you. Leave is granted, Mr Treasure. Are you ready to proceed, Mr Urquhart?

MR URQUHART: Yes, I am, thank you, sir.

COMMISSIONER: Thank you.

5

EXAMINATION-IN-CHIEF BY MR URQUHART

Mr Nicolaou, how old are you?---I am 44 years of age.

10 And you have some tertiary qualifications?---I graduated from the University of Western Australia with a Bachelor of Economics with first class honours in 1996 and I completed a Masters of Business Administration between 2005 and 2007 at UWA as well.

15 Were you with the Commonwealth Treasury after you graduated in 1997 and 1998?---That's correct. I was a graduate economist at the Commonwealth Treasury in Canberra for those two years.

20 And then from 1996 to 2003, were you at the State Treasury here in Western Australia?---1998.

I'm sorry, my apologies. Yes, 1998?---Yes.

25 And what was your positions there?---Various positions from a Senior Policy Advisor right up to a Principal Policy Advisor over those years, working in the revenue policy area and also the competition policy area.

30 And then from 2003 to 2015 were you with the Chamber of Commerce and Industry here in Western Australia?---That's correct.

What were your roles and responsibilities there?---So for the majority of that time I was chief economist at the Chamber of Commerce and Industry and held senior executive roles in the latter half of that tenure as well.

35 Then from 2015 to present, have you been working at ACIL Allen Consultancy?---That's correct, completing my time at CCI, I took up the role of Executive Director at ACIL Allen Consultancy which is a professional services firm that specialise in economics, public policy and strategy.

40 What sort of work have you done there?---A variety of work, all centred on economics. I'm an economist by trade and ACIL Allen has its origins in economics and policy, so the work that I've done there over my four years, just over four years, has been built around those types of work from financial reviews to economic impact assessments, to business benefit cost assessments, policy
45 development and the like.

Thank you. Just for the transcript, Commissioner, I will just confirm that ACIL is

spelt A-C-I-L and Allen is A-I-I-e-n. Mr Nicolaou, was ACIL Allen engaged by this Inquiry to report on the City of Perth's finances?---That's correct. In March 2019 I was approached to undertake a scope of works that has been presented in a slide deck that I provided and that review was completed - was tasked to be completed over a short period of time between April and May.

And you were assigned that job at ACIL Allen, anybody else assisted you?---So I was the project director for that engagement and I had a senior team of staff based in Perth, Brian Buckland and James Hammond, but also an analyst in Nick Marsh that also supported me in that role.

Specifically, did the Inquiry seek a report that provided advice on four major areas, being the adequacy of the City of Perth's strategic planning and financial planning, and management of business models being one?---That's correct.

The other or the others being analysis of the City of Perth's financial position and the underlying drivers of the City's financial position over time?---That's correct.

The third being a focus review of the City of Perth's parking business which you've referred to in your report as CPP?---That's correct.

And then finally, analysis of the City of Perth's rates model for residential and commercial properties and the degree to which there's any cross-subsidisation and any subsidisation arising from the CPP business?---That's correct.

Was your assessment period from the financial year 2011/2012 through to the financial year 2017/2018?---That's correct.

With respect to the City of Perth parking, and the rate setting, was that confined to a slightly shorter period due to data availability?---That's correct.

What period of time was that?---That was slightly shorter. In some instances, I think from financial year 2014 to 2018.

Have you described the financial review that you undertook as desktop in nature?---That's correct.

What do you mean by that?---The scope of works was confined to reviewing financials, so doing analysis of the financials provided to us, and reviewing any strategic or other documents that were provided to us. So we were desktop, confined to a desk. We weren't permitted to engage and test our findings or insights with staff of the City of Perth.

When you say "provided", is that by the City of Perth?---The Inquiry provided us what all the documents we needed to complete the - - -

So any documents you requested, you were able to be provided with those from the

Inquiry by the City of Perth?---That's correct. There was some delays at times but we did get all the documents we needed.

5 I think you've already told us that this review was completed in May of 2019?---That's correct.

And you prepared a report that was some - in excess of 50 pages in length?---That's correct.

10 However, did you also prepare a shorter version of that report in the sort of a format of a PowerPoint presentation?---We did. To brief the CEO of our broad findings from our substantive report, we prepare a PowerPoint style summary report.

15 Have you used the basis of that PowerPoint presentation for the purposes of giving your evidence today?---That's correct, provided a little bit more context just to make sure that the charts made sense to a fresh set of eyes, but broadly speaking it's the same presentation.

20 Thank you. Commissioner, if I may now go to those pages that are part of that shorter report. If we could have that up on the screen now.

COMMISSIONER: Thank you.

25 MR URQUHART: Madam Associate, that will be 3.1482, TRIM number, sir, 25087.

COMMISSIONER: Thank you.

30 MR URQUHART: Indeed, there are a number of graphs to illustrate the findings that you've made?---That's correct.

35 So if we can just deal then first with the first bar graph that appears on the left-hand side of that page and it's titled, "Overall operating financial performance - underlying cash basis and net operating balance basis", in millions of dollars. Can you take us through, firstly, that graph and tell us what that shows?---For sure. So there are two, I guess, views of the overall financial performance of the City of Perth being presented, one, the underlying cash basis which is a cash accounting approach to measuring performance. So it essentially measures money coming in,
40 money going out. The net operating balance is the accruals based approach to measuring financial performance. So that is an accounting treatment where value is recognised when the sale or activity takes place, rather than when the cash comes in, and it also accounts for other non-cash related items such as depreciation. So broadly speaking, they should present a similar view and in this
45 case it does but there can be differences from time to time, as we see in financial year 14 where there's a pretty big difference there and the underlying cash balance was in negative but that was due to a one-off instance where there was a cash

contribution that the City of Perth made to the Perth Citylink project.

Then you've made two observations at the bottom of that graph, the first being:

5 *The City's overall financial position has deteriorated over the study period, both in terms of the net operating balance and the underlying cash balance.*

10 ?---That's correct. So what the numbers show is that over the assessment period that we used, financial year 12 to financial year 18, at least the net operating balance has deteriorated from a high of \$26.1 million in financial year 2013, to a low of \$8.2 million by financial year 2018.

15 Is that a good segue to go to the next graph that appears on that page which highlights the net operating balance?---It is a good segue because what we are trying to show in the second chart is, okay, what are the drivers behind that performance, the overall performance, the headline performance in the first chart and when you match up operating revenue versus operating expenditure, you can see the difference between revenue and expenditure has narrowed over time, and that's due to the relatively stronger expenditure growth relative to revenue growth over that period of time.

20 So proportionately, the City's spending more than it's receiving?---Over that study period and we wanted to get as long a study period or assessment period as possible so that broad trends could be observed, rather than it being influenced by a dynamic in a very short period of time. So that's why we took a longer time period, and what we can see here is that there is a narrowing over time and that's due to the stronger growth in expenditure which, over that study period, increased by 33 per cent or \$42 million relative to revenue which increased by 17 per cent, or \$25 million over the same period.

25 That graph, you can see in brackets when describing the purple and the orange lines "(less PPL)", is that short for Perth Parking Levy?---That's correct.

30 And ESL short for Emergency Services Levy?---That's correct.

35 Can you explain why those two matters were removed for the purposes of this graph?---Essentially they have been removed because they are not within the control of the City of Perth, they are flow-through items. The City of Perth collects these taxes, which are in all essence taxes on behalf of the State Government, so it is recognised in both revenue and expenditure, so it nets out but what we wanted to try and observe is the underlying performance of the City of Perth over time.

40 [10.30 am]

45 Any other observations you'd like to make regarding those two graphs before we

move to the next?---No, I'm satisfied.

5 Thank you. So now we go to the next page, Madam Associate, this is 3.1483 now and the title is, "Revenue trends". Again, we will deal first with the graph on the left and the title is there, "Overall revenue trends by revenue line". So does this concern the major sources of revenue for the City over the timeframe we are talking about?---That's correct.

10 We can see from that graph that the major source of revenue is from rates?---That's correct.

Followed by parking fees and again, you haven't included the Perth Parking Levy in that?---That's correct.

15 Because that is an amount that's set by the State Government, is it?---It's a tax that is imposed on every car bay, non-residential car bay in the City and it's used to fund various forms of State Government expenditure but principally the CAT service, the Central Area Transit bus service.

20 And also that rate can vary from year to year, is that correct?---That's correct, and a chart a bit later will show how that has changed over time.

25 Then the third major source of revenue is service fees and charges?---That's correct.

So what does that incorporate?---A variety of fees and charges levied by the City which are in the substantive report. I can go through those if required.

30 Just generally?---I will have to have a look now.

Might that be at page 23?---The rates and parking fees are by far the largest but there are other fees and charges like waste management fees, and the like which are levied and fines that are levied by the City as well.

35 That's the fourth one and then the fifth one is interest earned, going back to the bar graph?---Yes, that's correct.

And then finally, other?---Yes, that's correct.

40 And as you've noted at the bottom of that graph, rates revenue has been not just the largest revenue source but has increased at a faster rate than any other revenue source?---That's correct. Over the study period, what we observed is that rates revenue has increased by around 58 per cent relative to its levels in financial year 2012 which is far larger than any other major head of revenue by the City of Perth.
45 The interesting observation there is that in financial year 2012, rates was around 15 per cent higher than the City of Perth's parking fees in that year and because of the different rates of growth, it's 58 per cent higher now than the City of Perth's

parking fees by the end of financial year 2018.

As you've also observed there, we can see from the bar graph in relation to parking fees, that the underlying revenue growth for that has been largely
5 unchanged?---That's correct, once the Perth Parking Levy has been removed.

Thank you, Mr Nicolaou. The next graph is titled, "City of Perth rates revenue trends by land use category", again in amounts of millions of dollars. So this is the breakdown of exactly where the City derives its income from rates, is that
10 right?---That's correct.

So it's divided into vacant, residential, commercial and office?---They are the four categories, yes.

15 Then you've made some observations there below that bar graph which is that the biggest increase has been in the residential rates?---That's correct.

Mr Nicolaou, can I ask you if you know the answer to this question: is that because there's been more residences established over these years or is it an
20 increase in the rates? I suppose we are going to get to that a bit later on, are we?---A little bit but principally it's due to the increase in the rateable value applied to residential property.

If we have completed with that bar graph, there's nothing else that you need to
25 draw to our attention?---No, other than the composition of the rates base has noticeably shifted towards residential properties with a greater proportion of total revenue from rates now derived from residential properties versus the other categories.

30 Thank you. If we go over to the next page, Madam Associate, 3.1484. Now we are looking at expenditure trends and the first graph on the left is the "City of Perth operating expenditure by category expenses." This is looking at the major areas where the City of Perth is spending its money?---That's correct.

35 We can see there that the most significant is staff?---That's correct.

Followed by services and contracts?---Yes.

40 Depreciation?---Yes.

The Perth Parking Levy?---Yes.

Other?---Yes.

45 And then contractors?---That's correct.

Underneath that, you've identified that expenditure growth has been driven almost

entirely by those first four expenditure groups?---That's correct.

5 What sort of observations can you make regarding, firstly, the staff expenditure?---By far the largest component of the total expenditure of the City of Perth. That's not uncommon for organisations of this nature, but what I guess is interesting when you look at the year to year comparison is the growth in staff expenditure over that assessment period of financial year 2012 through to financial year 2018. Overall staff expenditure has grown from around \$53 million to \$75 million over those years and then when you add in contractors, which in many cases perform the role that a full-time equivalent employee might, where that has increased from \$3 million over the same period to \$8 million, you do get an almost 50 per cent increase in expenditure associated with staff or contractors over that study period.

15 Indeed, that's the observation you make there in the second point below that particular graph, "Staff and contract labour is the largest expenditure capital for the City accounting for 47 per cent total expenditure in financial year 17/18"?---That's right.

20 With respect to the work you did regarding staff and the increase in staff numbers, did you encounter a problem gaining that type of information from the City of Perth?---We did have an issue in that we weren't able to source appropriate data on head count. So what you look at when you look at expenditure, it could be due to head count or it could be due to wage increases or it could be a combination of both. We weren't able to get a good record of head count movements over that period of time, so instead we have looked at the other side which is the inflationary side which is how much wages have increased over that period of time for the City of Perth relative to other comparable benchmarks which is the chart on the right.

30 We will get to that in a moment. Did you note anything about the workforce management function at the City?---There was some findings that we made throughout the document and they are sort of captured in the last few pages of this brief which - - -

35 We will get to that if you don't want to deal with it now, but just very briefly, what was that situation?---There was just no common single point of truth or single source of truth with respect to their HR from a FTE point of view, full-time equivalent job point of view, so we had difficulty in getting that data. It was ad hoc if we were able to get it so it wasn't something we were able to use to build up some richness in our analysis.

40 We will probably address that a little bit more later on. You mentioned the graph to the right. I understand the purposes of getting this information was to see comparative rates for staff increase with other government instrumentalities or Councils, is that right?---That's correct.

If we look across there at that particular graph, you've done a labour expenditure,

not just for the City it appears in that graph, but also for State Government, then Local Governments generally in Western Australia, Local Governments within Australia and then you've also made a distinction between the City of Perth's labour expenditure with the City of Perth plus contractors, is that right?---That's correct.

So those last two are the ones that appear in orange and purple and then the other three, various shades of grey but not quite 50?---That's correct.

10 So take us through then those three shades of grey and then the two that you did for the City of Perth?---So what we tried to do here is create an index by, I guess, looking at growth rates in wages across those benchmarks relative to the City of Perth with financial year 2012 being year 1. So what you can see over time is the wage inflation that has occurred in the City of Perth relative to other comparable
15 organisations or jurisdictions. So what we observed is that the City's labour expenditure, and that could be due to head count or due to wages growth, has increased at a faster rate than publicly available benchmarks over the assessment period and what we observed is that over that period it was 13.5 per cent faster than the State Government's direct employment costs, 15.6 per cent faster than a
20 benchmark of WA Local Governments, and 20.7 per cent faster than a benchmark of Local Governments labour expenditure at a national level. So on any of those measures, the City of Perth's labour expenditure has been growing at a much faster rate of growth than any other jurisdiction. What we observed then is if the City had contained its labour cost to a average of, say, the Local Government labour
25 expenditure benchmark for Western Australia, employment costs overall would have been \$40.4 million lower over that assessment period and \$11.3 million lower in 2017/18 alone.

When we are dealing with the total expenditure by the City, \$11.3 million
30 represents, offhand is it about 5 or 6 per cent of the - - -?---It would be, yes, of that.

That was a question without notice there, Mr Nicolaou. Yes, the expenditure for the financial year ending 2018 was just shy of \$200 million, \$193.8 million?---Yes, and if we were just to look at staff and contractor expenditure
35 which totalled \$83 million, obviously \$11.3 million of \$83 million is a sizeable amount.

Can I then ask you why you did the two line graphs for the City of Perth, first with just the purple one, "City of Perth" and then, "City of Perth plus contractors"?---It
40 was just through our deep dive that we did into the finances that we observed that staff expenditure had grown quickly but we had at the same time observed an increased use of contractor labour over the same period. So what we wanted to do is to combine the both to see whether any patterns emerge or any trends emerged because if you look at the City of Perth, the purple line, that started to level off and
45 decrease slightly over the last year of our assessment period but when you combine in the City of Perth wages expenditure or labour expenditure and included the contractor expenditure, then that trend continued to grow.

Right. So any gains that might have been made by the City of Perth of staff numbers plateauing was offset by the fact that there was an increase in the use of contractors?---Yes, potentially

5

[10.45 am]

Thank you, Mr Nicolaou. That just deals with generally your findings with respect to the City of Perth finances. If we can now just draw our attention to those two specific matters that you were asked to look at which was the City of Perth parking and rates. So if we can deal with the City of Perth parking first?---Sure.

10

Once more, did you prepare a number of graphs to illustrate the findings that you had made?---Yes, we have in the slide deck here. I guess some of the key ones are presented here.

15

Thank you. Madam Associate, in that case could we go now to 3.1486. So just generally speaking, what did you find with respect to the number of car parking bays available for use by the City compared to the number of bays available in other capital cities in Australia?---The observation hopefully is quite clear in these two charts here. It shows that the City of Perth Parking business is a significant business in its own right from a City of Perth point of view but when compared against other capital cities, it does show how significant it is and how extraordinary it is relative to other capital city Local Governments. It is certainly the larger provider of public parking within our City with 35 car parks under management, which is far greater than any other jurisdiction, the next highest being Adelaide which has nine car parks under management, with Brisbane, Melbourne and Sydney having two each under active management.

20

25

And this is indicated by the purple coloured bar graphs there on the far left-hand side?---That's correct.

30

So when we see 10, 20, 30, 40 going up the - is that the Y axis?---That's on the Y axis, yes.

35

That's the number of car parks?---The number of car parks, car park premises, and then that translates to the right-hand chart which is the number of parking bays and again, the City of Perth Parking business certainly sits out well ahead of any other capital city Local Government with 10,500 parking bays under management, compared to 6,000 in Adelaide, 1,140 in Brisbane, 248 in Melbourne and 1,171 in Sydney.

40

So obviously then, the City of Perth out of all the capital cities in Australia, has the greatest revenue for car parks that it owns, is that essentially it?---That's correct. It has the most significant non-rates related business compared to any other capital city's Local Government.

45

Thank you, Mr Nicolaou. If we go now to the next two graphs. Madam Associate, this is at 3.1487, and the bar graph that appears on the left there. I think you've referred to this a little while ago. This is the City of Perth Parking revenue for each of those financial years, the seven financial years that you looked at, and looking at the parking fees versus the Perth Parking Levy, is that right?---That's correct.

So the lighter shade of orange is the revenue from the Perth Parking Levy and the darker colour orange is the parking fees which would be retained by the City?---That's correct.

That bar graph strikingly points out what you stated a little earlier, that the Perth Parking Levy has increased more significantly than that part that's available for the City of Perth?---That's correct. So the observation out of that chart is, the CPP business, or the City of Perth Parking business, from a revenue perspective, hasn't really grown over that period of time. While revenue in total has increased by about 7.5 per cent over those seven years in the assessment period, that's below growth in inflation over the same period of time. So Perth's CPI, consumer price index, a measure of inflation for the City, has increased by around 10 per cent over that same period. So from an operating perspective, the City of Perth Parking business has been growing at a rate lower than general, inflation.

And with respect to the discrepancies in the increase in amounts for the Perth Parking Levy as compared to parking fees, we can see the line graph on the right-hand side of that page which starkly illustrates that?---That's correct, so it does show that any growth in the City of Perth Parking business at a headline level is largely an illusion because it is really a transfer of revenue that the City collects through the parking levy, to the State Government.

You have mentioned there that Perth Parking Levy received by the State Government is used to subsidise the CAT bus transport system?---That's correct.

But there is still a surplus, is that from your findings, that there's still a surplus of funds from the Perth Parking Levy?---That's correct. The Perth Parking Levy was once as a hypothecated levy or tax imposed by the State Government to take account of the costs associated with managing and operating the State's or the City's Central Area Transit bus service, the CAT service. Over time though, and as you see with the increase in revenue generated from the levy, between FY 14 and financial year 2016 where the rate increased, that hypothecation was broken and it's now used to fund other purposes now beyond just the CAT service, so it does fund other operations or other expenses of the State Government.

Then just going to that last sentence on your observations below the bar graph there, which sums it up, "Actual parking revenue generated by the City has been broadly flat over the period, growing by just 1.3 per cent per annum"?---That's correct.

Thank you, Mr Nicolaou. If we go now to the next two charts and that's 3.1488, thank you, Madam Associate. We are still dealing with the City of Perth Parking. So the bar graph there on the left, you've titled it, "CPP indirect costs allocated from City central finance by type" in millions of dollars. So we have four colour codings that appear there underneath that, Perth rates, Perth rent, Perth bin levy and internal cost allocation. Am I right in saying that the Perth bin levy, the grey shaded area, doesn't appear in the bar graphs; is that because it was too small to be included?---Yes, even if you squint I don't think you could see that.

10 Tell us about these, what does this graph show?---So as we observed in the previous charts, from a revenue perspective the City of Perth Parking business has been broadly unchanged over the assessment period and we observed similar trends from an expenditure perspective in terms of direct expenditure associated with the running of these parking facilities across the City of Perth's jurisdiction.

15 What this chart though shows is the indirect costs that are allocated to the City of Perth Parking business from the City of Perth more broadly and there are a number of indirect costs that are allocated. I'm not in a position to question, I guess, the adequacy or otherwise of the levels, but the observation here is that there has been an increase in indirect cost allocation to the City of Perth Parking business at a time when the business itself has been broadly flat in terms of its overall performance. So what we see here and the trends are showing in aggregate, that internal expenditure allocations increased by \$4.3 million from \$17.3 million in 2013/14, to \$21.6 million in 2017/18, an increase of 25 per cent.

25 So you say indirect costs, can you just explain a little bit more what that is?---In any organisation there are costs, corporate costs that are allocated to different business lines. It's good practice because it ensures that any business line within a broader corporate structure is appropriately accounting for some of the corporate overheads that are incurred from finance to Human Resources to other things, so the Executive Team, et cetera, all those costs associated with organisations should be allocated appropriately across different divisions or businesses within an organisation and what we are trying to show here is on the basis of the allocations that we could observe through the data that we could obtain, that was the breakdown of indirect costs that were allocated to that business by broad function or by broad activity, which included internal cost allocations, the bin levy, rent and rates.

You said "appropriately proportioned", how is that determined?---Typically businesses would use an activity based cost model. Good practice dictates that, where you allocate based on an agreed methodology, internal costs to different businesses based on an agreed approach, whether it be the size of the business, the floor space in a building, it could be a variety of different factors that help you understand what internal costs should be allocated to a different business line. We weren't able to obtain the information necessary to assess the efficacy or otherwise of those cost allocations but broadly speaking, they should be allocated in a way that reflects their use.

When you say you weren't able to find out, did you request that information?---That was a separate request that we made not long into our study where we asked for any evidence or any information that could help us understand their approach to allocating internal costs and we weren't able to obtain - while we were able to obtain a notional activity based cost model, they were just hard coded numbers, there was no clear rationale or logic behind why those numbers or those costs were at that magnitude in those areas.

So can you make any comment about the magnitude of these costs that were attributed to the City of Perth Parking?---There may be valid reasons for those cost allocations. We weren't able to obtain anything because there wasn't an appropriate document that helped to understand the method behind cost allocation, internal cost allocation, but it does seem unusually high, that the internal costs represent - on average over those five years, represented around 57 per cent of total expenditure incurred by the parking business itself. So it does seem high but we weren't able to investigate that any further.

Something you might be able to tell us a little bit more about is this concept of competitive neutrality. Can you explain something about that?---That was something that I was going to touch on at the very end but I can talk about that - - -

All right, we will do that at the end then?---Yes.

We won't disturb the method of you going through all this, so that's fine, we will address that at the end but it has something to do with the national tax equivalence regime, does it?---Yes.

Just an answer, yes is fine?---Okay, right.

Then we will address that later?---Absolutely.

So this next graph on the left-hand side of 3.1488 is titled, "The performance of City of Perth Parking portfolio, GP", which stands for?---Gross profit.

"Gross profit versus number of bays" in million dollars performance benchmark is the average gross profit per car parking bay, is that right?---That's right.

So explain this graph to us, if you could, please?---Scatter plots can be a bit technical and difficult to understand but we wanted to try and capture a view or an understanding of the performance of every facility under the City of Perth Parking business management and what we observed is there was quite a big difference in performance in terms of profit, which is the ultimate financial view of performance, across those facilities. On average, the average gross profit performance of every bay under the City's management was \$3,128. That was our calculation that we made. When we applied that average level of gross profit across all the active premises under the City's management, what we observed was that just 10 of those facilities achieved that average level of performance.

Or above?---But a significant number were under-performing relative to that benchmark that we established there.

5 So 10 out-performed the average and 25 did not?---That is correct. So that is shown in the chart here. The purple dots are those facilities. They are unnamed, other than one which is the outlier there, the Perth Convention and Exhibition Centre car park. Those purple dots are those that over-performed relative to that benchmark and generally speaking are ones that contribute to the gross profit of
10 the parking business but what was interesting though is there was a significantly greater number of those that were under-performing relative to that benchmark.

So you referred to the Perth Convention and Exhibition Centre car park as an outlier. It clearly is, as demonstrated by that graph?---That's correct. So it
15 generates a significant gross profit overall and it's certainly the largest in terms of number of bays as a facility under the management of the City of Perth.

Just before I move to your report on the rates at the City, are you going to also address what observations you made regarding the Business Plan of the City of
20 Perth Parking later?--- Yes.

Thank you. So if we could now turn to the City's rate settings now, please. Madam Associate, the next appropriate page for that matter is 3.1490. So the title here is, "Trends in City rate setting" and the first bar graph on the left is titled,
25 "City of Perth - differential rates by category, cents per dollar of gross rental value", is that right?---That's right.

You've again used the colours to indicate commercial, office, residential and vacant. So on the Y axis, 0.08, that is cents in the dollar?---Cents in the dollar,
30 that's essentially the rate that's applied for every dollar of rateable land.

So explain what this bar graph is portraying?---I guess the key observation here is that over time - differential rates are used by the City of Perth and we pass no judgment on that. It's not uncommon to see differential rates used. What we have
35 observed is that from financial year 2015, and you compare that to financial year 2019, the gap between the highest rated use versus the lowest rated has lowered over time and what that has meant is that residential in particular has increased quite - at a much higher rate in terms of the rates applied to residential property relative to other purposes, and office has also increased as well.

40 So residential is indicated by the light coloured purple which is the third column along each one?---That's right. So by financial year 2019, the gap between the highest and the lowest was a lot less than it was at the beginning of that assessment period. So it's reduced to a 38 per cent differential in terms of the cents per dollar,
45 compared to 100 per cent back in 2015.

Thank you, Mr Nicolaou. Then the next chart demonstrates the revenue that's been

5 raised by each of those four categories?---That's correct, and it marries or it looks
at revenue which is the light purple bar and it sits that alongside the gross rental
valuation of that category of land within the City of Perth's boundaries and what
we were trying to understand a bit more was the degree of revenue effort under
each category and what we observed is that residential and commercial categories
10 had a higher level of revenue effort in that they have a higher rate and therefore a
higher level of revenue is generated from those categories relative to the office
category, which is, the effort is less than, I guess, its correlation to the gross rental
valuation. A very technical chart but what we were trying to see is how that -
whether there was any cross-subsidisation which was part of the brief that we were
15 given, between categories under the City of Perth's rates base and what we then
tried to do is try and calculate a general rate that would apply across all categories
if it was to be the same rate, and generate the same level of revenue that was
generated in financial year 2018. What we found was that general rate would be
4.94446 cents in the dollar and when we applied that rate across those categories,
20 we found that office ratepayers would have paid an additional \$4.6 million in rates
in financial year 2018, while residential and commercial ratepayers would each
have paid \$2.3 million less each across the board. So it gives you a view of
cross-subsidisation that occurs. We weren't in a position to pass any judgment on
the efficacy or otherwise of that but we are just presenting the numbers there.

25 Yes, but that bar graph does starkly show the cross-subsidisation because the
lighter shade of purple for office is lower than the darker shade of purple which is
gross - - -?---Gross rental valuation.

Yes, and for the other three, it's either higher with respect to commercial and
residential and it would appear - it may be even - - -?---It's higher with vacant.

30 - - - fractionally higher for vacant as well?---That's correct.

35 So more effort's gone into generating revenue from residential compared to
offices?---That's correct, and it generally reflects the differential rates as presented
on the chart on the left-hand side where office rates are a lot lower than the other
three categories.

So simply put, it could be said that the residents are carrying a greater burden than
office holders?---That greater relative burden, yes.

40 Thank you, Mr Nicolaou. Would you like to say anything more about either of
those two charts?---No, I'm happy to continue.

45 Just the differential rates that apply, I think you've already said this, but that's
commonplace amongst Local Governments?---Yes, and we did try and test that
against other capital city Local Governments and the like, so differential rates
aren't uncommon. It's just the nature of, and the rationale behind any differential
rates, that's not something that we were able to observe.

Thank you. Now we can turn our attention to the summary of the key findings that you made, please, Mr Nicolaou. Madam Associate, this appears at 3.1492, thank you?---So what I've tried to do here for the purposes of this hearing is just to try and, in three separate slides, capture I guess the key findings that we observed through our substantive report and hopefully - and most of which probably are reflected in the earlier slides but there's some additional content as well that's been included as well, which wasn't related to a particular slide but it was related to some other observations that came through in our overall study.

Thank you for that. We have pretty much already addressed the City's overall financial position, you made the conclusion that it has deteriorated over the study period?---That's correct.

And that's simply because of the closing of the gap between the revenue expenditure and the operating expenditure?---That's right.

So that takes care of the first two dot points and then the third dot point there on the left-hand side, "Revenue growth has been largely driven by the growth in rates revenue", I think we have already addressed that. Then the fourth dot point makes the observation that you've just made a moment ago regarding the office properties as compared to the other commercial, residential properties. Then the expenditure growth, the second dot point, has been driven almost entirely by the four expenditure groups we have gone through, the staff expenditure up \$22 million, depreciation expenses up \$13.6 million. Just on that, there was nothing that you noted untoward about that or anything like that?---No. Depreciation is a difficult one to assess without having a deeper appreciation of things going on within the organisation. The fact that depreciation expenses are up could mean a variety of things but ultimately I think it's a reflection of the increased capital expenditure over that study period of time and good practice being that you start to depreciate those capital items over their useful life so that it's correctly accounted for, so you're not wearing the cost up-front, which is what you do on a cash accounting basis, as observed in the very first slide that was presented this morning.

Thank you. Then we have already covered the Perth Parking Levy and the increase in expenses there, and then the contract labour expenditure also was up as indicated by one or two of those graphs. Then your concluding point is that:

Staff and contract labour is the largest expenditure category for the City, accounting for 47 per cent of total expenditure in financial year 2018.

?---That's correct.

Then we go to the second column, again this is something we already have addressed about the City's labour expenditure increasing at a faster rate than publicly available benchmarks over the assessment period. Can I just ask you where you got those publicly available benchmarks for the State Government,

other WA Local Governments and Local Governments Australia-wide?---Yes.
You're testing my memory here but the State Government benchmark is based on
State budget papers, so publicly available, readily accessible. With the Local
Government benchmarks at a State and National level, I did get my team to do this
5 but there are benchmarks available that are publicly available through WALGA, I
think, the Western Australian Local Government Association, and then the
Australian equivalent, but also there are - I think the department that is responsible
for Local Government also has that sort of data available.

10 Thank you, Mr Nicolaou. The next dot point you've already addressed regarding
the fact that the City had contained its labour costs to the average Local
Government labour expenditure benchmark for WA and the lesser amount that
would be spent on staff if that was the case. Then finally, we have already
addressed the City being unable to produce a reliable estimate of actual staff head
15 count or a FTE, or actual head count basis for the assessment period?---That's
correct.

Can I ask you, did that strike you as unusual?---It was unusual because head count,
full-time equivalent numbers, it's a pretty key input into any budget setting and it's
20 an important indicator of the efficiency or otherwise of how an organisation's
running because it's the key input into any activity that the City undertakes.

Indeed, this last sentence there that appears is something we were going to come
back to about the lack of a centralised HR management information?---That's
25 right.

And:

30 *A lack of management information targets are likely to be contributing
to the substantial growth in the City's direct employment and
contractor costs.*

Why did you make that comment?---I guess it's our way of trying to piece together
information, and try and come up with some conclusions in relation to that
35 financial performance and marry that up against our research and analysis that we
undertook of the strategic documents, budget documents that were presented to us
also in written form, and I guess piecing those two together and given the
challenge that we had in accessing data on head count, our observations around the
KPIs that are set for the City of Perth, our concern was that there was not adequate
40 controls in the form of KPIs or otherwise, which could at least create some triggers
to challenge any growth over and above an adequate benchmark

[11.15 am]

45 Would you expect that as part of the KPIs?---Certainly an efficiency KPI I think is
good practice. It's certainly something that we look for when we do financial
reviews at all levels of government but also in relation to commercial operations as

well. You need to have a good handle on your cost base and given that the key cost is people, the fact that there was not some adequate or any KPIs associated with, from a financial point of view, the cost of the business, that was a concern from our perspective.

5

So that good handling seemed to be lacking with the City?---There certainly didn't seem to be the focus on expenditure or an expenditure control as part of good financial management, from our observations. There were KPIs that were put in place, they were KPIs that are required of Local Governments such as the City of Perth, so they are following what they have been tasked to do but one of the gaps that we observed in the range of KPIs that are used by the City is that none of them really tackle one of the key issues faced by any organisation, which is cost control.

10

COMMISSIONER: Mr Nicolaou, when you've got staff and contract labour as your largest expenditure category, and going up?---Yes.

15

Shouldn't that be a driver to know exactly what your head count is?---That's why it was a concern from our perspective. We would have thought that there were those controls in place in terms of the annual budget setting, in terms of the visible transparent key performance indicators that the City should be measured against and there didn't seem to be those controls in place, governance, financial or otherwise.

20

MR URQUHART: So who do you say is responsible for that, or ensuring that there are adequate controls?---Ultimately it is the responsibility of the Executive Team, the CEO, the Chief Financial Officer or equivalent in the City of Perth, and the line managers or Directors of each Directorate within the City of Perth to be measuring that, be exploring that, be testing assumptions around the level of expenditure that's being incurred by the City, which is, as shown in the slides through this slide deck here, is high relative to any comparable benchmark.

25

30

Would I be right in saying, the larger the organisation, the more important that we have these effective KPIs?---Absolutely, and also given the nature of the City of Perth's revenue base as well. They have a significant business in the City of Perth Parking which generates significant cash to the City which can mask financial issues if there was cash flow coming in, and this is not an issue for the City of Perth alone, this is an issue that confronts many government agencies, organisations. When there aren't adequate controls put in place in the good times, it can come back to bite you when the tide turns.

35

40

Mr Nicolaou, you mentioned the City of Perth Parking, so that would be a good segue into going on to the next page then, 3.1493. On this page we see that you've made some specific comments regarding those two areas that you were asked to look at more precisely, the City of Perth Parking undertaking and the City of Perth rates model. So if we can deal first, please, with the parking. That first dot point, you've already identified that fact about the large number of off street parking premises the City has as compared to other cities throughout Australia. In the next

45

dot point you've estimated that the City of Perth Parking undertaking generated \$202.6 million of free cash flow for the City over the five year period. So when you say "free cash flow", what do you mean by that?---So what we tried to calculate here was the gross profit of the City of Perth Parking business prior to all the internal recharges and the like. So it's really the amount of money that business makes available to the City of Perth for whatever strategic priorities there are at the time. So it's a significant cash flow generator for the City, generating what we estimate to be \$202.6 million of free cash flow.

10 Yes, and then that other sentence says:

Approximately 21 per cent of the City's total operating revenue cash flow generation over the period.

15 ?---That's correct.

So if it had a similar number of car parking bays than the next highest number in a capital city, which as I recall is Adelaide?---Yes.

20 If it had the same number as Adelaide, it would be running at a loss, wouldn't it?---The cost structure of the City of Perth would be materially different because it wouldn't be able to sustain the level of expenditure that it currently sits at without the City of Perth Parking business.

25 The third dot point I would like you to amplify a little bit further and I will just read that out:

Given the size of this business undertaking it is not appropriate for the City to continue to operate the CPP business without an adequate Business Plan, be it required to produce one according to legislation or not.

35 Did you have an opportunity of looking at the Business Plan that was in place for the City of Perth Parking?---We did. We had access to that. I think that was made available to us as part of our discovery.

40 Yes, and when you had a look at that, did you draw that conclusion, that it was not an adequate one?---Certainly it wasn't - we didn't see it as a Business Plan. It certainly didn't tick off on the requirements of a detailed Business Plan that, I guess, a normal commercial operation would be required to do. It didn't have that adequate requirement to explore the financial costs and benefits or otherwise, the risks, governance and the like. It was quite a short sort of targeted brochure style plan that, I don't know, we saw as something being for public consumption rather than for internal use in planning the strategy around the City of Perth Parking business.

45 That is the whole point of the Business Plan, isn't it, for it to be used internally as

well as externally?---Yes, absolutely and in that form that we saw it at that time, it certainly didn't satisfy the requirements of being an adequate Business Plan.

5 Again, someone with a background in finance and financial management, would understand what the key components are of a Business Plan, or you would expect to know the key components of a Business Plan?---You would expect that. Given the size of the business to the City of Perth and given, I guess, the revenue that it generates, fulfilling the broader strategic objectives of the City of Perth, it is important that that business is running well and that business takes into account a range of issues that are pertinent to that parking business, which also includes the next point, being that it satisfies the test of accounting for a competitive neutrality, which we can touch on in a second. So it is the responsibility of the Director or the line manager responsible for the business to prepare the Business Plan that meets the requirements of the City of Perth more broadly, its Executive Team and its CFO.

20 What are the problems that can arise from a Business Plan that's inadequate?---The problems that can arise are, I guess, you do see in some of the results that we have seen in this briefing pack this morning. We have observed flat to negligible revenue growth over that period of time, which there may be sound justification behind that but we weren't privy to any of, I guess, the strategic rationale behind what the City of Perth wanted to do with that business. We have the issue of costs and internal costs that are getting recharged to that business that's not observed. If there was a sound plan in place that articulated the direction, the vision that the City wanted from that business, then ultimately with that good governance around it, you would expect to see the performance follow.

30 COMMISSIONER: Given that it general rates \$202.6 million of free cash flow and given its importance to the financial viability of the City of Perth as you've described it, it sounds to me like it's pretty fundamental to have what you would describe as an adequate Business Plan. Can you think of any reason why there wouldn't be one there?---All that we could observe, sort of reaching back to our early discovery phase around this at the time was that there was some push-back around the need to complete a Business Plan as all and a Business Plan that resolves the issue around the City of Perth Parking business being a major undertaking under the Act, resolve the issue around the need for it to, I guess, address issues of competitive neutrality, how the business operates in a competitive environment where there are other parking businesses and the City of Perth has an advantage to the extent that it doesn't pay the same - the taxes that a private operator would, but there seemed to be, through some correspondence and the like, that there was some push-back around that. I could only observe that this was done just to - it seemed like it was done to tick a box.

45 Is that good financial management?---Not from my perspective. I think when you're developing up a detailed Business Plan you need to have a very clear rationale as to the why it exists, a very clear rationale as to what the direction is, a very clear understanding of the financials behind that business, a very clear

understanding of the risks, the inherent risks, internal or external, around that business and a very clear understanding of any growth or strategic growth opportunities that need to be considered, and future investment that needs to be made in that business as well. That needs to be all captured in a Business Plan.

5

Were those things that you've just described the inadequacies or some of the inadequacies in this Business Plan?---None of those things were recognised in the Business Plan.

10 Mr Urquhart, apologies for the interruption.

MR URQUHART: That's fine, thank you, sir.

15 In answer to the Commissioner's questions, Mr Nicolaou, you mentioned push-back; are you able to tell us from what quarter that push-back came from?---Again, I'm searching my brain a little bit here but from what I understood and from what I observed in the correspondence and the like was that there was a view that the City of Perth Parking business, because it's been in operation for many years and the Local Government Act which requires a major undertaking to build a Business Plan and so forth, it didn't need to accommodate those requirements under the Act

20

[11.30 am]

25 So were you aware of what section of the City of Perth had that push-back or you received that information regarding the push-back?---That was observed through the Directorates responsible for the City of Perth Parking business.

30 You mentioned the inadequacies of the Business Plan that you had a look at. Had that been generated in more recent times with respect to this period that you were looking at?---Yes, it was a recent document that was drafted and at the time of our study, which was again I will have to make mention it was done in April and May, it hadn't been approved by the Council, or had been sent back.

35 The Commissioners?---Or the Commissioners, yes, sorry.

Had you come across any other business plans that had been prepared prior to that one?---No.

40 Had you requested those?---We requested all documents, strategic, financial, relating to that business it was a specific Term of Reference for us.

Which would include any Business Plans that were either present or previous?---That's correct.

45

How often should a Business Plan be drawn up, for an entity of this size?---A Business Plan should be detailed in terms of its first development but it should be

reviewed annually, just like any good budget that is developed, or good budget process.

5 Mr Nicolaou, you've already touched on this in answer to questions from the Commissioner and we are also going to come back to this next dot point which reads:

10 *In addition, it's not clear from the information provided by the City, that the City fully accounts for competitive neutrality in the CPP undertaking.*

15 Can you just explain to us, please, this concept of competitive neutrality?---This is a concept that arose out of national competition policy when it was drafted in 1995 and essentially, what competitive neutrality means is that it ensures that there's no unfair advantage to an organisation by virtue of its ownership, public or private. So in the case of, and this is most pertinent in public organisations that compete in broader markets, they have an unfair advantage to the extent that they don't pay Commonwealth and State taxes, whereas private organisations do. So a model was implemented at the time where public corporations were required to account for their tax that they would otherwise pay and this is the national tax equivalence regime, so that there was no unfair advantage.

20 So this was introduced by the Federal Government in the mid 1990s, does that sound about right?---Yes, 1995 was National Competition Policy.

25 How is it enforceable?---It's enforceable by the Commonwealth State agreements at the time and I think National Competition Policy is etched in the operations of any public corporation now.

30 So essentially the idea is to level the playing field?---Essentially.

35 And you saw no evidence that the City had taken into consideration this competitive neutrality concept?---No, we weren't able to observe any recognition or accounting of that implicit advantage that the parking business receives.

Should it have been?---It should. It's a significant business, given the size of its cash flow generation and it does operate in a competitive market and with those competitors required to pay tax, as any organisation would.

40 Then the final dot point there, Mr Nicolaou, in the first column underneath, "CPP undertaking" reads:

45 *The City's parking undertaking is evidently a significant cash flow generator for the City. No other Local Government in Western Australia, no other capital city Local Government in Australia has access to a line of cash flow like the CPP affords the City.*

HEARING RECOMMENCED AT 11.55 AM

MR John Andrew NICOLAOU, recalled on former oath:

5 COMMISSIONER: Yes, Mr Urquhart.

MR URQUHART: Thank you very much, Commissioner.

10 Mr Nicolaou, just before the break we were going to turn our attention to 3.1493 in the second column there under the heading, "City of Perth rates model." Indeed, just casting my eye down those four dot points that appear there, it would seem we have already addressed those matters in some detail, unless you wish to emphasise any finding you've made there or observation?---No, I think we have covered it adequately prior.

15 In that case we will turn to the final page and that is 3.1494 which is titled, "Summary of key findings 3.3." So we see a subheading there, Mr Nicolaou of, "Governance" and that is something we have touched on briefly but not in any great detail and the first dot point there reads:

20 *The trends in the City's financial performance can be traced to issues in relation to its governance.*

25 Are you able to amplify that observation a little more, please?---I think it will start to flow through in terms of the subsequent points but the observation through the detailed financial analysis and the insights we drew from that, and then we married that up against our review of all the strategic and planning documents that the City - that I was able to get access to as part of this review, what became clear to us, and this is I guess our judgment at an overall level, was that and it happens a lot in
30 organisations where the financial performance starts to fall away over time, is that there aren't the appropriate controls put in place and governance around the organisation to ensure that emerging issues are picked up earlier and addressed early.

35 Your second dot point there refers to, "Limited integration of strategic planning documents"?---Yes.

40 What do you mean by that?---So what our review of all the City of Perth's planning documents was that it ticked the boxes in terms of its requirements under the Act, Local Government Act 1995 in terms of developing an integrated planning and reporting framework, as it's termed, and that gives the necessary structure around the City's strategic direction and it's certainly legislated under the Act as well. While that was all well structured and well presented, the documents that we were able to observe, there just didn't seem to be the integration of those planning
45 documents between the very high level, the 10 year plans, right down to the annual budgets and then the documents that sit under that. So without those linkages, and those linkages ultimately come together through financial forecasting, without that

then they have limited value as a tool to govern the performance of the City of Perth.

5 It was an issue, was, the financial forecasting or lack thereof?---We weren't able to observe any long-term financial forecasting that had the application or the detail necessary to link to long-term plans of the City of Perth from a strategic point of view. So if you have a strategic planning document that has some very good messages around visionary - very good visionary components to it but without the way to execute that plan and without the funding allocated to the actions to do that, 10 then you're not going to see the success come through in terms of the outcomes

[12 noon]

15 Thank you. The next dot point refers to the major undertaking for activities with an annual expenditure over \$5 million as required by the Local Government Act, and you identified that the City of Perth Parking was a major undertaking. Did you note any other entities run by the City that could be regarded as a major undertaking?---No, that was certainly the main - the one that we observed, was the City of Perth Parking business.

20 It was significantly over that minimum amount of \$5 million?---Yes, and even if it was wasn't required under legislation, I think good practice would dictate a business of that size and scale with those issues around it, around competitive neutrality and the like, there should be a sound financial plan that underpins it.

25 The final dot point on the first column there talks about the activity based costing that the City, you've described as, notionally applies to its finances. I don't think we have discussed this in much detail so far. So could you just amplify your observations with respect to this area?---So as part of our discovery, we asked for the City's activity based costing model, which is used to allocate internal expenditure to different Business Units and we eventually received that but our observation from that spreadsheet that we were able to access was that it just had allocations, percentages applied to different Business Units but without explanation as to why. There was no - the why attached to, and that's where we need - you need a sound methodology that is objective in nature that removes, I 35 guess, some of those opportunities to shift funds between areas and notionally improve the performance of organisations based on the way in which you shape the way in which you allocate internal costs, across different businesses.

40 Indeed, what you've indicated there in bold type in the last three lines is:

ACIL Allen's high level observation suggests the City's approach to ABC is not based on sound principles and appears to be instead used as a tool to undertake cost shifting across the organisation.

45 Is that conclusion or observation based on the lack of information you were able to receive?---That was our observation on the basis that there did not exist a manual

associated with the activity based cost model and there was no other
correspondence that allowed us to understand why certain costs and at certain
levels of magnitude were allocated to different Business Units. There was a lot of
churn. Costs were moved about quite a bit and as I've indicated in the dot point
5 there, 57 per cent of the total expenditure over that assessment period was
reallocated. So there is a lot of cost shifting. I'm not intending to make that
pejorative in any way, it's just that it does point to evidence of cost shifting though
across different Business Units.

10 COMMISSIONER: Mr Nicolaou, when you operate a business like this without a
manual that requires you to outline the bases of your allocations, what are the risks
for the organisation?---The risks are that you could be hiding under-performance, I
guess at its worst or a Business Unit or a business within an organisation that is
under-performing and potentially exposes risks to an organisation overall and that's
15 why an activity based cost model, you don't want to see it abused. It needs to be
based on a sound methodology and you want it to be as objective as possible, so
it's based on something that's tangible, that's understood by all and if there's reason
to change those allocations, there needs to be a justification for that.

20 Would I be right in thinking that if you don't have an adequate Business Plan and
you don't have adequate key performance indicators of the kind that you spoke
about earlier in your evidence, then not having a manual outlining the basis of your
cost allocations compounds the problem?---It can and that was, I guess, our
concern and why we have wrapped up these comments here, that it came
25 throughout our study under the title of governance. I think from a financial
governance point of view, you want to know how the costs are - where the costs
come from, how they are allocated, if they are a shared service, because you want
to know the true performance of a Business Unit or an entity that sits within an
organisation.

30 Pardon the interruption, Mr Urquhart.

MR URQUHART: That's fine, thank you, sir.

35 So with an organisation the size of the City, would you expect such a
manual?---You would. I guess I was surprised to the extent that it - we were
expecting to see some sort of methodology because there was an activity based
cost model that was developed but when that wasn't available, that was a surprise.
I don't think the City of Perth's alone on this one, I'm sure there are many
40 organisations, many Local Governments, many State Government agencies that
don't - that suffer the same fate in terms of not having a good structure around their
financial governance but in the context of the City of Perth and what we viewed
based on the evidence that we had, that was a concern.

45 The Council of a City, being Perth, should really lead by example, should it not,
for other Local Governments in this regard?---Yes, I would expect that.

The next dot point you've identified in the second column there, refers to the City's KPIs. Can you see that there?---Yes.

5 You've touched upon the KPIs already, I will just take you to the second sentence there:

However, there are a number of limitations with the suite of KPIs which limit their effectiveness as a performance monitoring tool.

10 How difficult is it to develop effective KPIs?---It is a challenge for any organisation to develop up KPIs that give the appropriate view to the decision-making around their effectiveness and efficiency of the organisation or Business Unit. There are guidelines that exist and we looked at guidelines that are produced by the Department of Treasury in Western Australia under the outcomes based management framework and it makes it very clear that yes, you need to look at effectiveness of the City of Perth in the question of this hearing, but you also need to look at efficiency, because if you don't focus on efficiency, then ultimately the implication of that is that over time revenue will have to rise because the costs are at a level that is inefficient and ultimately that means high rates for those paid by City of Perth ratepayers. So it's a very important set of KPIs to focus on efficiency. It's one that's - it's probably easiest as well to develop because they are largely financial in nature, rather than relying on measurements on outcomes which can be more difficult to measure and that's why you do get measures, KPIs that the City of Perth use as well which are based on surveys rather than of residents or other stakeholders.

That last dot point deals with the fact that you, as a measuring exercise, looked at the KPIs that are used to measure financial performance to other cities in Australia, namely Melbourne and Sydney and you were able to observe that their KPIs were far more effective?---Yes, but most importantly they did have an efficiency KPI in that suite of KPIs. The challenge that we had in reviewing at a very early stage the City of Perth's performance was there was no focused efficiency indicator that they deploy to measure how efficient the City of Perth is in delivering its services to the community. It's not that they are going against requirements, there are Local Government reporting financial indicators that exist that they abide by. I guess our challenge was that while they are reporting on those, a lot of those don't really lend itself to interrogation of how efficient the City is in performing the services to its community.

40 Mr Nicolaou, can I conclude by just asking you this: what are those three areas that you came across with respect to the financial performance of the City that you believe requires the most addressing?---Overall, and I've tried to capture that in those final three slides, is our review really brought to light issues in relation to expenditure that the City undertakes in running the City, and that then can be traced to staff costs. So within that first, if I'm talking more broadly here, but that first category, expenditure control must be a priority for the City of Perth. Understanding what its cost base is and building up a set of metrics, both to

address and ensure the appropriate reporting of those key elements of expenditure, primarily staff costs I think is paramount. In terms of - I guess that's probably expenditure being one broad category.

5 Yes?---The second one around revenue, if we are to look at revenue overall, that really gets traced back to the two major lines of revenue, which is the City of Perth Parking business and its rates base, but primarily the parking business. It is a significant undertaking. It is an undertaking that generates significant cash flows for the City of Perth, it is an undertaking though that doesn't have an adequate
10 Business Plan and it's not clear that it's integrated into the long-term planning around the City of Perth, financial, strategic or otherwise. So I think that's an area that should be explored also and then I guess finally, it's more in relation to governance more broadly and ensuring that the framework around which the City of Perth governs itself from a financial and a strategic point of view, that is
15 integrated well, there are the appropriate tools in place, financial - a single view of the organisation I think it would be paramount to ensure disparate sets of data don't continue to exist but it comes together into a single view to have an overall view of the organisation, so from a financial governance, then that gets addressed and within that then, KPIs, key performance indicators that touch on those key pressure
20 points, key issues that are of concern to the financial sustainability of the City of Perth, as well as those long-term strategic priorities that are articulated in their strategic plans.

25 Would you see any merit in a Local Government such as the City of Perth having a dedicated Chief Financial Officer or finance officer?---It is a sophisticated - significant and sophisticated business, if you're to look at the City of Perth overall and it generates significant revenues and it is providing services to a capital city Local Government authority and/or the stakeholders within that, so there are expectations that it needs to be very well managed. It needs to be efficient in how
30 it runs itself and it delivers to the standards that the community requires. I think a big part of that requires good financial governance which starts with a CFO that has that primary task.

35 Just bear with me for one moment, please, Mr Nicolaou. Yet again Mr Parkinson, as is usually the case, Mr Nicolaou, I always have to ask an additional question thanks to the assistance of that man to the left of me. Something that you have touched on but I would just like to see if you can expand on this. We have talked about the disparate or separate sets of data as causing a problem. I think it's also something called the silo effect; are you familiar with that terminology? Is that
40 something that you found in your examination?---Look, drawing back on, I guess, on our earlier review of everything, it did seem very siloed, the organisation, and that came through particularly with the City of Perth Parking business which had its own financial model advisors that operated independent of the overarching City of Perth finance team, which was surprising and I guess the expectation would be
45 that they are all under the same family, this is the City of Perth and there needs to be an integrated view, a comprehensive view, a single view of the whole organisation, not disparate parts coming together and then presenting themselves.

No more Post-it notes there from the left, so that completes my questions, thank you, sir.

5 COMMISSIONER: You spoke about the whole of family approach, you've spoken about it in the context of one Directorate getting its own financial advice; did you, in your examination, also come across disparate management in terms of human resources?---M'mm.

10 Was that also something that you encountered?---The struggle that we had was there was no single view from a human resource management perspective which should come through in the finances, because it is the largest cost base of the City. So without that single view of the cost of people and people management, then there are issues that can emerge over time and costs can start to escalate beyond
15 what's comfortable from a broader point of view. So from our initial examination and I always have to qualify, we weren't able to test a lot of these things through, I guess, a deeper round of stakeholder consultation internally, but our assessment was that they all operated very independently of each other and there wasn't that - they didn't come together as a single view and from a human resources
20 management point of view, that was a surprise as well.

Did you notice this separation in any other areas than finance and human resources?---I think they were the critical ones. The fact that the City of Perth Parking business didn't have an adequate Business Plan meant, I think from a
25 strategic point of view as well, there may have been some separation there between that business and the rest of the organisation.

Who would you regard as the appropriate person to ensure that that kind of situation didn't prevail in the management of the City?---Ultimately, with any
30 organisation, it's the CEO, it's the Board, it's a Chief Financial Officer and it's the Executive Team more broadly that need to act collegiately and appropriately challenge each other to ensure that the best outcomes are delivered from a whole of City point of view and we weren't able to test that but from some of our observations through some of the information that was presented to us, there did
35 seem to be some dysfunction from that point of view.

Is there anything arising out of that, Mr Urquhart?

40 MR URQUHART: No, there's not, thank you, sir.

COMMISSIONER: Thank you. Mr Treasure, do you have an application to make?

45 MR TREASURE: No, Commissioner.

COMMISSIONER: Are there any other housekeeping matters?

MR URQUHART: No, there's not, thank you, sir.

5 COMMISSIONER: Thank you. In that case, Mr Nicolaou, I'm going to discharge you as a witness but before I do that, I want to thank you for your evidence, it's been of enormous assistance to the Inquiry?---You're welcome.

I will now adjourn the Inquiry.

10 MR URQUHART: Thank you, sir.

WITNESS WITHDREW

**AT 12.20 PM THE MATTER WAS ADJOURNED
UNTIL TUESDAY, 8 OCTOBER 2019**

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