

ITEM NUMBER: 9.1

CONFIDENTIAL REPORT

LOAN RECEIVABLES

Pursuant to Section 83(5) of the Local Government Act 1999 the Report attached to this agenda and the accompanying documentation is delivered to the Audit Committee Members upon the basis that the Audit Committee consider the Report and the documents in confidence under Part 3 of the Act, specifically on the basis that Audit Committee will receive, discuss or consider:

- d. **commercial information of a confidential nature (not being a trade secret) the disclosure of which could reasonably be expected to prejudice the commercial position of the person who supplied the information, or to confer a commercial advantage on a third party; and would, on balance, be contrary to the public interest.**

Recommendation – Exclusion of the Public – Section 90(3)(d) Order

- 1** That pursuant to Section 90(2) of the *Local Government Act 1999* Audit Committee hereby orders that the public be excluded from attendance at this meeting with the exception of the Staff in attendance at the meeting in order to consider Report No: 290/17 Loan Receivables in confidence.

 - 2.** That in accordance with Section 90(3) of the *Local Government Act 1999* Audit Committee is satisfied that it is necessary that the public be excluded to consider the information contained in Report No: 290/17 Loan Receivables on the following grounds:
 - d.** pursuant to section 90(3)(d) of the Act, the information to be received, discussed or considered in relation to this Agenda Item is commercial information of a confidential nature (not being a trade secret) the disclosure of which could reasonably be expected to prejudice the commercial position of the person who supplied the information, as this would prejudice the commercial position who supplied the information.

In addition, the disclosure of this information would, on balance, be contrary to the public interest. The public interest in public access to the meeting has been balanced against the public interest in the continued non-disclosure of the information. The benefit to the public at large resulting from withholding the information outweighs the benefit to it of disclosure of the information.

 - 3.** The Audit Committee is satisfied, the principle that the meeting be conducted in a place open to the public, has been outweighed by the need to keep the information or discussion confidential.
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Item No: **9.1**

Subject: **LOAN RECEIVABLES**

Date: 29 August 2018

Written By: Manager Finance

General Manager: Business Services, Mr R Bria

SUMMARY

In order to complete the financial statements for the year ended 30 June 2018 an assessment is required of community loans that are owed to Council and whether there is any objective evidence that they will not be fully repaid. This assessment has been done and it is presented to the Audit Committee for review.

RECOMMENDATION

That the Audit Committee advises Council that:

1. **It has received and considered an assessment of community loans receivable as at 30 June 2018.**
2. **The current impairment amount of \$517,780 be maintained for impairment of community loans receivable as at 30 June 2018.**
3. **In accordance with Accounting Standards the impairment amount be reviewed and updated annually.**

RETAIN IN CONFIDENCE - Section 91(7) Order

- 4.. **That having considered Agenda Item 14.1 Loan Receivables (Report No: 290/17) in confidence under section 90(2) and (3)(d) of the *Local Government Act 1999*, the Audit Committee, pursuant to section 91(7) of that Act orders that the report, attachments and minutes be retained in confidence for a period of six months and the Chief Executive Officer is authorised to release the documents when the Audited Financial Statements are presented to Council.**
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COMMUNITY PLAN

Culture: Being financially accountable

COUNCIL POLICY

Not Applicable.

STATUTORY PROVISIONS

Local Government Act 1999

Local Government (Financial Management) Regulations 2011

BACKGROUND

The 2017/18 financial statements include financial assets amounting to \$2,222,701 referring to loans receivable from community clubs. With the exception of the Glenelg Football Club all community clubs are meeting their principal and interest repayments.

As at 30 June 2018 the Glenelg Football Club owed Council \$2,029,922. The background and details of the Glenelg Football Club loans are discussed as part of this report.

In order to finalise the financial statements an assessment is required as to whether the loans receivable amount will be realised.

REPORT

Background - Glenelg Football Club Loans

In 2001 Council entered into a loan agreement with the Glenelg Football Club under which the Club borrowed \$2.5 million from Council to fund its building redevelopment and upgrade program. Council funded the loan by borrowing from the Local Government Finance Authority (LGFA) and on-lending to the Club on identical terms (ie. a 'back-to-back' loan).

The Club had met its principal and interest payments up to October 2012 at which point the Club approached Council to restructure its loans including a 2-year interest-only term. The following key dates and Council decisions summarise the response to the Club requests and developments since that time:

- 11 December 2012 - Council agreed to re-structuring the loans by providing a 24 month interest-only term.
- 27 August 2013 - Council noted the on-going financial performance strategies to improve the Club and resolved to advance new loans up to \$500,000.
- 14 October 2014 - Council resolved to continue interest only repayments on existing loans for a further 24 month period.
- 8 March 2016 the Club met with Council regarding its financial position, forecast SANFL proceeds from sale of the AAMI Stadium Precinct Land and a proposal to reduce the loan amount owing to Council key decisions were as follows:

- Council agreed to work with the Club to restore its longer term financial viability while mindful of discharging its obligations to its ratepayers.
- Council considered that any further debt reduction was unacceptable and proposed the appointment of an independent investigative accountant to assist the Club and Council to fully understand the Club's financial position and obligations.
- Council also sought assurance that the SANFL proceeds from the sale of the AAMI Stadium Precinct Land would be applied to repay Council loans. A working party was established to monitor financial sustainability.
- 26 April 2016 - Council endorsed a letter to the Glenelg Football Club outlining Council's considerations and actions (as above), recognising that the financial situation is complex.
- September 2016 - letter received from the Club dealing with the initial \$250,000 SANFL land divestment fund distribution. Council agreed that the proceeds be first applied to satisfy the Club's debt of \$88,000 to the Australian Tax Office and the balance to be held by the SANFL pending a determination by Council. Council also agreed to engage BRI-Ferrier as an investigative accountant and that the report be provided in confidence.
- 25 October 2016 - Council received in confidence the BRI Ferrier report and resolved that the report be released in confidence to the Audit Committee in order to assist in the determination of the Club's ability to meet future loan repayments.
- 31 October 2016 – Audit Committee received loans receivable report (Report 276/16). An impairment amount of \$400,000 as at 30 June 2016 was recommended to Council.
- 22 November 2016 – Council considered report (285/16) which included the BRI-Ferrier (independent investigative accountant). Key decisions were as follows (refer minute C221116/584 for full details):
 - Council re-affirms its commitment to support the Glenelg Football Club in its objective of long-term sustainability.
 - A proposal was put to the Club, SANFL, and ANZ to release funds and reduce overall indebtedness – including first tranche (\$162,000) to be applied to repay Council's secured debt, and the Club's debt demolition campaign funds be applied to repay the ANZ.
 - Council negotiate a sharing arrangement of further SANFL proceeds with the ANZ in the proportion of 4/5 to Council and 1/5 to the ANZ.
- 13 December 2016 – Council considered correspondence from the Club and reduced the lease payment amount to \$40,000 for 3 financial years to 31/10/19.
- 24 January 2017 – Council considered responses from the Club and the ANZ in relation to debt reduction. Key decisions were as follows (refer minute C240117/644 for full details):
 - Council re-affirms its commitment to support the Glenelg Football Club in its objective of long-term sustainability.
 - That Council's CEO and agents negotiate the first tranche of the SANFL proceeds on a 2/3 to Council (ie \$108,000) and 1/3 to ANZ Bank (ie \$54,000).
 - That Council's CEO negotiate future SANFL proceeds to be applied on a 4/5 Council, 1/5 ANZ – in the event that this could not be reached within 6 weeks the repayment basis be 2/3 Council and 1/3 ANZ.
- 1 and 2 February 2017 – Council received \$108,000 being first tranche of the SANFL distribution based on a 2/3 Council, 1/3 ANZ split.

- 10 May 2017 – The Club wrote to Council seeking additional support to continue the delivery of its service to the community including agreement to pay 2/3 of the SANFL proceeds over the next 6 years.
- 16 May 2017 – Council workshop to consider response to letter, options and future strategy – facilitated by BRI -Ferrier.
- 23 May 2017 – Council formally considered a response to the Club. Key decisions were as follows (refer minute C230517/787 for full details):
 - Council's CEO be authorised to engage recognised professionals to act as Council agent in achieving negotiated settlement with the Club and SANFL.
 - Council accept a SANFL dividend sharing scheme of 2/3 Council, 1/3 ANZ – with funds to be paid direct to Council and covered by a binding agreement.
 - Past interest owed be written-off and future interest for 2 years up to 31 October 2019 not be charged.
 - The Club's ability to pay interest be reviewed after that time (ie 31 October 2019).
 - Loan principal repayments by the Club be reviewed after the final SANFL dividend instalment has transpired (ie October 2022).
 - The Club president and CEO meet annually with Council's Mayor and CEO following the release of the Clubs end of year accounts (ie after 31 October).
- 20 October 2017 – Council received \$166,666.67 via direct credit the second tranche of the SANFL distribution based on a 2/3 Council, 1/3 ANZ split.
- 27 February 2018 – Council received a report (51/18) on the Glenelg Football Club Annual Financial Statements for year ended 31 October 2017. Council noted that the financial position had improved over the 12 month period as a result of Council measures to support the clubs objective of long-term sustainability (minute C270218/1059).

Loan Receivables – Accounting Standard Requirements

Council's general purposes financial statements are prepared in accordance with Australian Accounting Standards (AAS). Australian Accounting Standards Board (AASB) 139 – Financial Instruments: Recognition and Measurement, paragraphs 58 to 70, covers the topics of impairment of financial assets including loan receivables. Impairment means the carrying amount of the asset is more than the amount that is expected to be recovered. Providing for impairment does not mean a write-off or debt waiver has occurred as it is a provision only and will continue to be reviewed by Council.

The standard requires an assessment at the end of each reporting period as to whether there is an objective evidence that a financial asset is impaired. The amount is therefore reviewed annually in conjunction with preparing the general purpose financial statements. AASB 139 para. 59 states that a financial asset is impaired only if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset.

As part of the finalisation of the 2015/16 financial statements the Audit Committee reviewed the loan receivable amount for the Glenelg Football Club. The committee noted that at that time two main events had occurred that met the requirements of the accounting standard. These were evidence of significant financial difficulty and the granting of financial concessions at the request

of the Club. After considering a number of assumptions the amount impaired at that time was \$400,000.

The impairment amount was reviewed for the 2016/17 financial statements by the audit committee (report AC290/17) noting that Council's financial commitments and strategies had supported the long term financial viability of the Club. The report included an updated present value model based on revised assumptions using an original effective interest rate of 6.66%. The amount of impairment was increased by \$117,780 to \$517,780.

Glenelg Football Club – 2017/18 Loan Receivable Assessment

The amounts owed by the Glenelg Football Club are recorded in the financial statements of Council as a financial asset. As at 30 June 2018 the total amount recorded as owing from the Club is \$2,029,922 with an impairment provision of \$517,780.

Financial results – year ended 31 October 2017.

During 2017/18 Council received and assessed the audited financial statements for the year ended 31 October 2017 for the Club (Report 51/18). The assessment used common financial performance ratio analysis applied to the consolidated results. The results are summarised as follows:

Liquidity Ratio

Current Ratio = current assets/current liabilities. If the ratio is 1 it means the club has the exact amount of current assets to pay of its current debts.

Consolidated result	Period ended 31/10/17	Period Ended 31/10/16	Analysis/Comments
Current Assets	\$193,829	\$338,460	
Current Liabilities	\$1,672,658	\$1,785,564	
Current Ratio	0.12	0.19	Indicates that the Club appears to have increasing difficulties in meeting its short term obligations. During 2018/19 a further \$275,000 will be distributed from the SANFL from land divestment funds and this will contribute to funding current liabilities.

Solvency Ratios

Long term debt to total capital. Equates to long term debt divided by total liabilities and total members funds. Lower percentages means the majority of the club is financed by member funds.

Consolidated result	Period ended 31/10/17	Period Ended 31/10/16	Analysis/Comments
Long term debt	\$1,869,340	\$2,639,381	Reduced due to SANFL land distribution
Total liabilities plus member funds	\$7,210,626	\$7,450,646	
Percentage	26%	35%	Indicates an improved position with members funds increasing their level of funding

Debt to Equity Ratio. Equates to total long term liabilities divided by total member's funds. Lower ratios indicate stronger debt management.

Consolidated result	Period ended 31/10/17	Period Ended 31/10/16	Analysis
Long term liabilities	\$1,849,124	\$2,707,977	Partly reduced in due to SANFL land distribution and movement of ANZ bank bills to current liabilities
Member funds	\$3,638,844	\$2,957,105	
Ratio	0.51	0.92	Indicates an improved position

Profitability Ratios

Profit margin. Measured by net income divided by total revenues.

Consolidated result	Period ended 31/10/17	Period Ended 31/10/16	Analysis
Net income	\$681,739	\$14,278	Improved due to SANFL Distributions and payroll tax refund
Total revenues	\$5,095,697	\$5,026,275	
Percentage	13.4%	0.3%	Indicates an improved result

The assessment concluded that the overall financial performance and position of the club had improved compared to the previous year as a result of the Council measures to support the Club's long term sustainability.

Additionally the results showed that the net cash profit after adjusting for extraordinary items was \$263,192 for period ended 31/10/17 compared with \$72,416 for period ended 31/10/16.

Financial forecast – year ended 31 October 2018.

During June 2018 the Club has provided to Council half yearly financial reports for the period ended 30 April 2018. The results indicated reduced profit forecast due to reduced patronage on game days, reduced bar sales and gaming income. The operating profit (before depreciation) forecast was reduced by \$74,000 to \$39,000.

Given this forecast it is anticipated that the Club will not meet the SANFL requirement of a consolidated operating result before depreciation of \$100,000 for 2017/18. This was an existing assumption in determining the provision for impairment amount.

The remaining assumptions for 2017/18 are unchanged from the 2016/17 and are as follows:

- The Club will be in existence for at least the next 15 years in order to receive the SANFL Land Divestment proceeds and make loan repayments on existing loans.
- Proceeds from the SANFL Land Divestment Fund will be applied to repaying Council debt in accordance with the Deed of Priority and agreed SANFL arrangements.
- All existing loans with the club that are due for review in 2022/23 will be refinanced over ten years at the current LGFA CAD variable interest rate (currently 3.75%).
- The Club will commence principal repayments on remaining loans after all the SANFL proceeds have been distributed and applied.
- Interest only payments will be negotiated from 2019/20 until 2022/23.
- No additional loans will be advanced to the Club from Council to maintain the Club's financial viability noting that while the Council is committed to supporting the Club it has not yet determined its future lending strategy to the Club.

SANFL – Land Divestment Timings

The SANFL has advised the Club of the timing of the remaining Land Divestment payments as follows:

Payment Date	Amount	2/3 Council Share
October 2018	\$275,000	\$183,333
October 2019	\$275,000	\$183,333
October 2020	\$300,000	\$200,000
October 2021	\$350,000	\$233,334
October 2022	\$300,000	\$200,000
Total	\$1,500,000	\$1,000,000

Impairment calculation and effective interest rate

The impairment amount is calculated by comparing the difference between the carrying amount of the loans, and the present value of estimated future cash flows discounted at the loan's original effective interest rate. The original effective rate is what would have been calculated at initial recognition. This has been determined as 6.66%.

Present Value Cash Flow Model

AASB 136 para. 33 explains the basis for estimating future cash flows. In measuring projections reasonable and supportive assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset need to be made.

A present value model has been prepared based on the updated assumptions listed above using the original effective interest rate of 6.66%. The assumptions represent management's best

estimate of the future economic conditions including Land Divestment payment timings. They also assume that the Club will meet the SANFL requirement of an annual operating surplus of \$100,000 and that it will make future principal and interest repayments as they arise. These assumptions will be reassessed when loan repayment negotiations occur in the future. For interest payments this will be in 2019/20 and for principal payments 2022/23.

The model has been updated to include the SANFL proceeds received during 2017/18 and the impairment provision is calculated at \$405,998 being an effective reduction of \$111,782.

However given the club's current year financial performance and reduced operating result forecast it is considered prudent to maintain the current impairment provision at \$517,780. The provision amount and assumptions will continue to be annually assessed.

BUDGET

This report is recommending that the provision for impairment be maintained at \$517,780. This will not affect the 2017/18 operating result or the provision for impairment in the Statement of Financial Position.

LIFE CYCLE COSTS

While there are no direct life cycle costs an annual assessment of impairment of loans receivable is required under Australian Accounting Standards.

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