



— Shire of —
Donnybrook Balingup

**REPORT ON SIGNIFICANT ISSUES
IN THE 2019-20 AUDIT REPORT**

DECEMBER 2020

BACKGROUND

Under the Local Government Act 1995, the Shire of Donnybrook Balingup is required to prepare an Annual Financial Report each financial year and that report is to be the subject of an independent audit.

The Shire's 2019-20 audit was conducted by the Office of the Auditor General and their report, received on 11 December 2020, is attached at **Appendix 1**.

Section 7.12A(4) of the *Local Government Act 1995* requires a local government to:

“(a) prepare a report addressing any matters identified as significant by the auditor in the audit report, stating what action the local government has taken or intends to take with respect to each of those matters; and

(b) give a copy of that report to the Minister within 3 months after the audit report is received by the local government.”

Section 7.12A(5) further requires:

“Within 14 days after a local government gives a report to the Minister under subsection (4)(b), the CEO must publish a copy of the report on the local government's official website.”

For the year ending 30 June 2020, the Auditor General identified a significant adverse trend in relation to the financial position of the Shire in relation to two statutory ratios present in the Financial Report that did not meet the minimum standard as set by the Department of Local Government, Sport and Cultural Industries (the Department). These ratios being the Operating Surplus Statutory Ratio and Asset Sustainability Statutory Ratio have been under the Department's recommended levels for at least three years. The Audit report also raised a compliance matter in relation to the inability to calculate another statutory ratio as at 30 June 2020 being the Asset Renewal Funding Ratio.

Three ratios indicators of a local government's financial performance are measured by the following ratios:

Operating surplus ratio

$$\frac{\text{operating revenue minus operating expense}}{\text{own source operating revenue}}$$

own source operating revenue means revenue from rates and service charges, fees and user charges, reimbursements and recoveries, interest income and profit on disposal of assets.

The Operating Surplus Ratio measures the extent to which revenues raised cover operational expenses (including depreciation). The Department considers the ratio standard is met if the ratio is above 0.00. To achieve a positive level in the ratio requires operating revenue (excluding capital grants and contribution) to be greater

than operating expenditure (including depreciation).

It is typical of a local government similar to the Shire of Donnybrook Balingup to have an operating surplus ratio that does not meet the minimum requirements. This result reflects a reliance on sources of funding other than Council's own source funds such as rates.

A number of additional major items also directly influence the results of the Operating Surplus Ratio, such as:

1. The timing of operating grant funds being received in one financial year and expenditure being incurred in another e.g. pre-payment of the Federal Government Financial Assistance Grants.
2. The exclusion from the ratio of recurrent capital grants (such as specific purpose road grants) as a revenue.
3. The funding of operating projects from reserve funds. All operating expenditure must be included in the ratio calculations, however the funds from cash reserve are excluded, resulting in an apparent lower ability to fund operating expenditure.

In order to improve its Operating Surplus Ratio, the Council has limited options available to it. One measure could be to increasing rates substantially, however, this must be balanced with the community's capacity and willingness to pay.

An alternative is to review the Shire's major operating costs, including employment costs, materials and contracts, however, to achieve the required cost savings would have a dramatic adverse impact the level of service which the Shire is able to deliver to the community.

Asset sustainability ratio

$$\frac{\text{capital renewal and replacement expenditure}}{\text{Depreciation}}$$

capital renewal and replacement expenditure means expenditure to renew or replace existing assets;

The asset sustainability ratio measures the extent to which assets managed by the Shire are being renewed and replaced over time. The Department considers the ratio standard is met if the ratio is above 0.90, meaning that spending on renewal in any one year is 90% of the level of depreciation in that year.

The Shire's Asset Sustainability ratio has been under the target level of 0.90 for the past three consecutive years resulting in this item being raised as a significant adverse trend.

asset renewal funding ratio

$$\frac{\text{NPV of planned capital renewals over 10 years}}{\text{NPV of required capital expenditure over 10 years}}$$

The asset renewal funding ratio measures the alignment between spending expected in the long-term financial plan on asset renewals and the timing of asset renewal requirements set out the asset management plan(s). The closer the ratio is to one, the closer alignment.

ACTION TO BE TAKEN

Action to be taken on the Operating Surplus Ratio in the future

The Shire of Donnybrook Balingup does not have the immediate capacity in its current financial structure to bring the ratio in line with the Department's benchmark in the short term. The Shire will seek, as part of its long-term financial planning process, to make improvements to the Operating Surplus Ratio over time as opportunities present to improve revenue sources and make efficiencies in operating expenses.

Action to be taken on the Asset Sustainability Ratio in the future

The Shire is planning on a substantial capital works program over the next five years based on renewing and upgrading key assets and this is predicted to result in the ratio being above the benchmark during this time correcting this short-term issue.

Action to be taken on the Asset Renewal Funding Ratio in the future.

The asset renewal funding ratio requires a completed assets management plan for all categories of assets and a current long term financial plan. The Shire has completed all the asset management planning required for the ratio denominator however is just in the last phase of completing the long-term financial plan. As this plan was not completed at the time of the audit the ratio could not be calculated. It is expected this ratio will be able to be calculated in 2020-21.