

SHIRE OF DUMBLEYUNG

ORDINARY MEETING OF COUNCIL MINUTES

21 APRIL 2022

10.2 DIRECTOR OF INFRASTRUCTURE REPORT

Nil

10.3 TOWN PLANNERS REPORT

Nil

10.4 DIRECTOR OF CORPORATE SERVICES REPORT

10.4.8 SIGNIFICANT ADVERSE TREND – SHIRE OF DUMBLEYUNG 2020/21 AUDIT REPORT

LOCATION/ADDRESS:	N/A
NAME OF APPLICANT:	N/A
FILE REFERENCE:	0006 – Financial Management/Audit Reports
AUTHOR:	Director of Corporate Services
DISCLOSURE OF INTEREST:	Nil
REVIEWED BY:	Chief Executive Officer
DATE:	6 April 2022
ATTACHMENT:	Report on Significant Adverse Trend
VOTING REQUIREMENT:	Absolute Majority

OFFICER RECOMMENDATION/COUNCIL RESOLUTION:

Motion 2022/036

That Council receives the Report on Significant Adverse Trends associated with the 2020/21 Audit Report.

Moved Cr Lukins

Seconded Cr Doney

Carried 6/0

PURPOSE

To consider the significant adverse trend in the Operating Surplus Ratio identified in the audit of the financial statements for the year ended 30 June 2021.

STRATEGIC IMPLICATIONS

Nil

STATUTORY ENVIRONMENT AND POLICY IMPLICATIONS

Local Government Act 1995 Section 7.12A

FINANCIAL AND STAFFING IMPLICATIONS

Nil

RISK IMPLICATIONS

This item has been evaluated against the Shire of Dumbleyung's Risk Assessment and Acceptance Criteria. The perceived level of risk is considered **Low** despite the risk of some external negative sentiment about the audit opinion as released.

COMMUNITY ENGAGEMENT AND CONSULTATION

Nil

BACKGROUND

Section 7.12A(4) of the *Local Government Act 1995* requires local governments to report on matters identified as significant by the auditor and to indicate what action(s) the local government has taken or intends to take in respect of the matters.

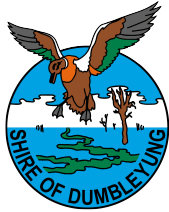
The Office of the Auditor General identified as part of its audit of the Shire's financial statements for the year ended 30 June 2021, that the Operating Surplus Ratio was showing a significant adverse trend and had not met the minimum standard as set by the Department of Local Government, Sport and Cultural Industries (the Department).

OFFICER'S COMMENT

In the Department's opinion, the Operating Surplus Ratio is a measure of a local government's ability to cover its operational costs and have revenue available for capital funding or other purposes. It is calculated by dividing the difference between operating revenue (less grants and contributions for the development or acquisition of assets) and operating expense by the own source operating revenue (revenue from rates and service charges, fees and charges, reimbursements and recoveries, interest income and profit on disposal of assets).

Most country local governments struggle to fully fund asset depreciation from its own revenue sources and there is reliance of external grant funding to assist with asset renewal. The main ways to improve this ratio could include increasing rates substantially or reducing operating expenditure. Both measures could have significant adverse effects on the community; increasing rates may render people unable to pay, while reducing operating expenditure may result in reducing services that the community values.

The Shire of Dumbleyung has made it clear to the Office of the Auditor General that it believes this ratio is an inappropriate measure of rural Shire financial performance and should be removed as a relevant ratio in the future. The Office of the Auditor General have advised they are in discussion with the Department as to the appropriateness of the benchmarks of the required financial ratios. No changes have been made thus far and it is anticipated that the matter will become an annual issue until satisfactorily resolved (removed).



SHIRE OF DUMBLEYUNG

REPORT ON SIGNIFICANT ADVERSE TREND

1. Background

The *Local Government (Audit) Regulations 1996* section 10(3) requires the auditor to identify any financial trends which it considers adverse and of concern. The Shire's 2020/21 audit report was received from the Auditor General on 17 March 2022 noting that the Auditor General has identified a significant adverse trend in relation to the financial position of the Shire. The Shire of Dumbleyung has not met the minimum standard as set by the Department of Local Government, Sport and Cultural Industries (the Department) for the Operating Surplus Ratio for the past four years.

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

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

"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."

2. Report Detail

Under the Department's interpretation, if a local government consistently achieves a positive operating surplus ratio and has soundly based long term financial plans showing that it can continue to do so in the future, having regard to asset management and the community's service level needs, then it is considered financially sustainable.

The ratio is calculated using the following equation:

$$\frac{\text{Operating revenue minus operating expense}}{\text{Own source operating revenue}}$$

A positive ratio indicates the percentage of total own source revenue available to help fund proposed capital expenditure, transfer to cash reserves or to reduce debt. When the ratio starts to drift into negative territory it indicates a deficit and higher risk (according to the Department).

The Department's minimum benchmarks for this ratio are as follows:

Advanced standard – 15% or greater

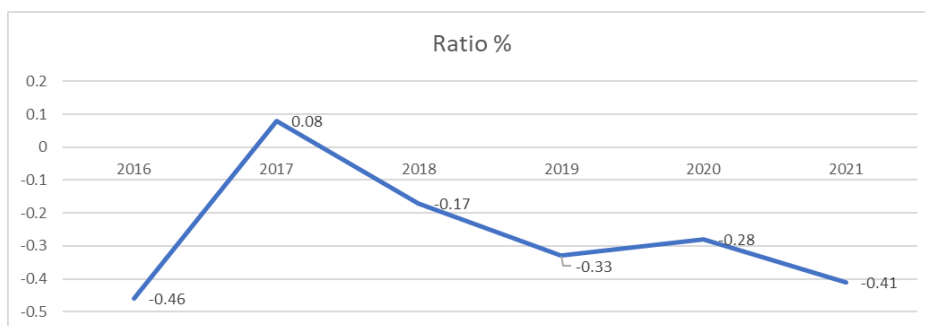
A ratio of greater than 15% indicates the Shire is providing a strong operating surplus which will give flexibility in the future in relation to operational service levels and asset base.

Basic Standard – between 1% and 15%

Below Standard – 0% or less

The Operating Surplus Ratio calculation excludes grants received to assist with capital works but includes depreciation expense. It is argued by the local government sector that these grants are an integral component of revenue for local government and long-term financial plans are predicated on receiving these funds. Removing these funds from the ratio calculation has a negative impact on the ratio and unreasonably distorts the result.

It is typical of local governments like the Shire of Dumbleyung to have an Operating Surplus Ratio that does not meet minimum requirements. This result reflects a reliance on sources of funding other than the Shire's own source funds such as rates, to be sustainable. As seen below, the Shire's ratio has only met the basic standard once in the last six years.



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

- The timing of operating grants being received in one financial year and expenditure incurred in another, such as via pre-payment of the Financial Assistance Grants.
- The funding of operating projects from reserve funds. All operating expenditure must be included in the ratio calculations, however the income from reserve must be excluded, resulting in an apparent lower ability to fund operating expenditure.

In order to improve the Operating Surplus Ratio, the Shire has limited options available to it. The measure could be improved by increasing rates substantially however this must be balanced with the community's capacity to pay. The measure could also be improved by the Shire reviewing (and reducing) its major operating cost centres, including employment costs, materials and contracts however this will almost certainly adversely impact the level of service which the Shire is able to deliver to the community.

The current ratio benchmarks adopted by the Department is a 'one size fits all' approach. It is understood most rural local governments have not had an Operating Surplus Ratio that met the standards set by the Department, and there has been an indication by the Auditor General that this benchmark may need review.

3. Conclusion

The Operating Surplus Ratio requires the Shire to ensure that its own revenue sources grow at the same or a greater rate than its operating expenses, including depreciation. It is well known that most country local governments struggle to fully fund asset depreciation via its own revenue sources and there is a reliance on grant funding such as Regional Road Group and Roads to Recovery to assist with asset renewal expenditure.

The Shire is very aware of its ratio performance in relation to benchmarks set by the Department however disagrees that this ratio is relevant to small rural Shire's as excluding grant funding from the ratio calculation results in the ratio being an inaccurate reflection of small rural Shire's financial position. It is the Shire's view that this ratio should be removed without further delay.