



To : Audit Committee

RE: Significant Matter Raised in Audit Report

Background

Due to the Auditor highlighting a matter that they deem to be a significant in the 2018/19 Audit Report, the Shire was statutorily required to follow the process set out in the section below:

Section 7.12A(4) of the Local Government Act 1995 states 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 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) of the Local Government Act 1995 also states:

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.

The Operating Surplus Ratio in Detail (extracted from DLGSCI guidelines)

Calculation:
$$\frac{(\text{Operating Revenue MINUS Operating Expense})}{\text{Own Source Operating Revenue}}$$

Purpose: This ratio is a measure of a Local Government's ability to cover its operational costs and have revenues available for capital funding of other purposes.

Standard: **Basic** standard (0.01 and 0.15) **Advanced** standard (>0.15)

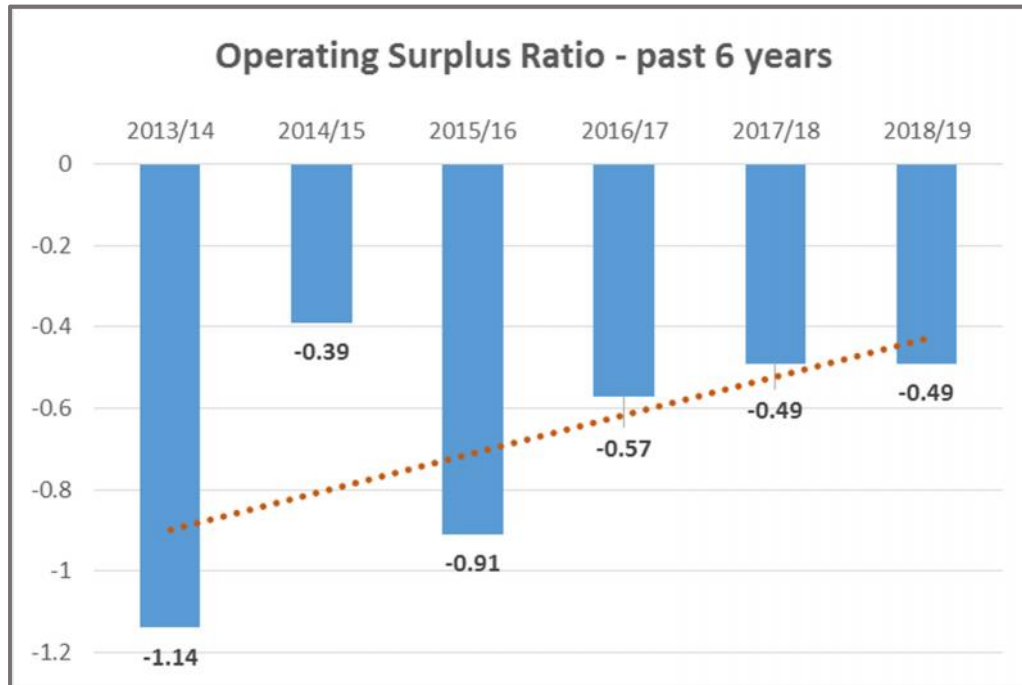
The Operating Surplus ratio for the Shire of Manjimup in the last 4 years is:

- 2015/16: -0.91
- 2016/17: -0.57
- 2017/18: -0.49
- 2018/19: -0.49

Comment

The Shire of Manjimup's Operating Surplus Ratio has been under the DLGCI's standards since the ratio was introduced in the 2013/14 financial year. The Operating Surplus Ratio for any Local Government that significantly relies on grant funding should always be below the DLGCI's standard for this ratio, as it assesses own source

revenue against operating expenditure (inclusive of depreciation). It is acknowledged that the Shire's Auditors believed the ratio indicated a "significant adverse trend" however on review of the Operating Surplus Ratio since introduction has actually demonstrated an improving trend at the Shire albeit the ratio is still below DLGCI's benchmark.



Like several of the ratios specifically applied to Local Government in Western Australia by DLGCI, there are considerable anomalies that arise during the calculation of the Operating Surplus Ratio that significantly weaken the interpretive usefulness of the outcome when judging the sustainability of a Local Government. Specific issues that affect the Shire of Manjimup when calculating this ratio are:

- The Shire is very grant reliant and receives substantial financial assistance grants each year. Unless significant population growth, economic growth, significant increases (70%+) in existing rates or the ability to rate additional land occurs, the Shire will continue to be heavily reliant on grant funding into the future;
- The Shire has a 1,358km road asset base arising from being the largest Local Government district land mass in the South West. This means that a substantial non-cash depreciation expense forms a significant part of the base calculation. The depreciation expense of road infrastructure is highly subjective that is open to manipulation and as it exists as a non-cash item should be reconsidered for its worth in contributing the Operating Surplus Ratio;
- The Shire auspices many operating grant programs like the Commonwealth Home Care Programs, NDIS services etc. As these programs are grant related the grant is removed from the Operating Surplus calculation, however the expenditure must remain in the operating expense portion. In most cases if this grant money was not received the programs would not go ahead which equates to approximately \$3.8M per year in Shire expenses and therefore should not be included in the Operating Surplus Ratio calculation; and

- When Council has any form of a carry forward, the carried forward expense from a previous year affects the ratio, however the funding for that expense is not recognised.

The DLGSCI's use of the Operating Surplus Ratio as a measure of Local Government sustainability is a significantly flawed approach when viewed in isolation. It is understood that the ongoing review of the Local Government Act 1995 will involve many submissions from the Local Government sector regarding the usefulness of the ratios as it is an area that has become nonsensical as a measure of Local Government sustainability when viewed in isolation. It is understood that the Shire's Auditors have reported this matter as a "significant adverse trend" however it is only their role to assess against the statutory and guidance framework established by others and not to make comment on the usefulness of any particular ratio that is supposed to measure the sustainability of a Local Government. It is understood that the Auditor General also considers the review of Local Government ratios as a priority.

Proposed Action

1. The Operating Surplus Ratio trend at the Shire is continuing to improve. This should be continued to be monitored and consideration given to further action if required if declines occur in future years;
2. The Shire of Manjimup Long Term Financial Plan recognises that the Shire has a significant asset burden and seeks to fund an additional \$100,000 to \$150,000 in capital renewal funding each year with Shire officers seeking to match municipal funding with grant applications to further enhance renewal works; and
3. The Shire requests that the DLGCI urgently consult with the Local Government sector to consider temporary measures that offset anomalies identified in the Operating Surplus Ratio prior to a potential future legislative amendment.



Greg Lockwood
Director of Business
Shire of Manjimup