



Report on Adverse Trends in Financial Position

ITEM 8.2.2 – 2018-19 SIGNIFICANT ADVERSE TREND – OPERATING SURPLUS RATIO

LOCATION/ADDRESS: N/A
NAME OF APPLICANT: N/A
FILE REFERENCE:
DISCLOSURE OF INTEREST: Nil
DATE OF REPORT:

SUMMARY:

If a significant matter is reported in an audit report section 7.12A of the Local Government Act 1995 requires a response from the local government and a report to be prepared stating what action has been taken or is intended to be taken in respect to matters raised within the audit report. The operating surplus ratio of the Shire of West Arthur has been below the required level for two consecutive years and therefore has been included in this year's audit report.

BACKGROUND:

In November 2017, proclamation of the *Local Government Amendment (Auditing) Act 2017* introduced a number of reforms to auditing laws. The legislation requires local governments to examine an audit report it receives and implement appropriate action in respect to the significant matters raised.

The Auditor General's Independent Auditor's Report for 2018-19 identified a significant adverse trend in the financial position of the Shire (attached). Specifically, that the Operating Surplus Ratio has been below the Department of Local Government, Sport and Cultural Industries ("the Department") standard for the past two years.

Local governments must prepare a report addressing the significant matters identified in their audit report, which is to be considered by the local government's audit committee before being adopted by council.

Operating Surplus Ratio =
$$\frac{\text{(Operating Revenue MINUS Operating Expense)}}{\text{Own Source Operating Revenue}}$$

The purpose of this ratio is a measure of a local government's ability to cover its operational costs and have revenues available for capital funding or other purposes. The Department has determined that a ratio below 0.01 (1%) is below the standard required.

The following table highlights the Shire's ratio as calculated for the last four financial years, including the figure for the 2018/19 financial year:

	2015/16	2016/17	2017/18	2018/19
Operating surplus ratio	-0.80	0.06	-0.14	-0.73

Own source operating revenue is made up of rates, fees and charges, interest income, profit on disposals of assets, reimbursements and recoveries, and other revenue. Small regional local governments are limited in their ability to increase own source revenue and are more reliant on grant funding for renewal of assets.

\$836,000 bridge expenditure was included in operating expenditure in the 2018/19 year. This income was recognised in the previous year and was reported as restricted cash. Changes in accounting

regulations will now require income and expenditure to be recognised in the same year which will alleviate this timing issue in the future. Without recognition of the bridge expenditure the ratio in 2018/19 would have been -0.351, still outside the recommended standard. Council would need to increase income or decrease expenditure by a further \$809,552 to meet the recommended standard this year. The ratio will also be affected by the timing of the Federal Assistance Grants. A substantial prepayment of the FAGS grants has been prepaid in recent years however if not consistently prepaid will influence the ratio.

A significant expense recognised in operating expenditure and included in the ratio calculation is depreciation. The depreciation expense recognised in 2018/19 was \$2,075,389 (including \$499,841 bridge depreciation).

The ratio does not recognise capital road or capital project funding and this income is specifically excluded from the ratio. Non-operating road grants from Roads to Recovery (Federal) and Regional Road Group (State) were \$779,552. These capital grants are used to fund asset renewal as recognised in the depreciation expense.

The ratio reflects a reliance on sources of funding other than Council's own source funds such as rates, to be sustainable. To have an operating surplus ratio which does not meet the minimum requirements is typical of many local governments.

CONSULTATION:

The report has been prepared in consultation with other local governments. The majority of local governments cannot meet the recommended standard.

STATUTORY ENVIRONMENT:

In November 2017, proclamation of the *Local Government Amendment (Auditing) Act 2017* introduced a number of reforms to auditing laws. The legislation requires local governments to examine an audit report it receives and implement appropriate action in respect to the significant matters raised.

POLICY IMPLICATIONS:

There are no policy implications.

FINANCIAL IMPLICATIONS:

The Operating Surplus Ratio is expected to be reported as having a significant adverse trend in the future. The ratio will continue to be monitored through the long term financial planning and budgeting process.

STRATEGIC IMPLICATIONS:

This item aligns with the community's vision and aspirations as contained in the Shire of West Arthur Corporate Plan 2019 to 2023. Specifically, it relates to the following strategy(s):
5.2 Financial management and decision making will be transparent, accountable and in an accessible format for the public

COMMENT

The Shire of West Arthur Audit Committee will review this Item at its meeting on 17 March 2020 and make a recommendation to Council from this meeting.

VOTING REQUIREMENTS:

Simple majority

COUNCIL DECISION (COMMITTEE RECOMMENDATION) – ITEM 8.1.5

Moved: Cr Adam Squires

Seconded: Cr Graeme Peirce

That Council:

1. Notes the significant adverse trends in the financial position of the Shire, as identified in the Auditor General's Independent Auditor's Report for 2018-19, stating that the Operating Surplus Ratio is below the Department of Local Government, Sport and Cultural Industries standard and that the Shire of West Arthur monitor through the long term financial planning and budgeting process; and

2. Authorises a copy of this report to be forwarded to the Minister for Local Government and be published on the Shire's official website.

CARRIED6/0