



SHIRE OF BRIDGETOWN-GREENBUSHES

2019/20 REPORT ON SIGNIFICANT ADVERSE TRENDS

JANUARY 2021

1. Background

Under the Local Government Act 1995 the Shire of Bridgetown-Greenbushes is required to prepare an audited Annual Financial Report each financial year.

The Shire's 2019/20 audit report was received from the Auditor General on 7 December 2020 and is attached at appendix 1 of this document.

A key audit requirement requires the auditor to identify any financial trends which it considers adverse and of concern. For the 30 June 2020 year, the Auditor General has identified two significant adverse trends in relation to the financial position of the Shire. The Shire of Bridgetown-Greenbushes has not met the minimum standard as set by the Department of Local Government, Sport and Cultural Industries (the Department) for the Asset Sustainability Ratio and Operating Surplus Ratio for the last three financial 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 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 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

A series of performance indicators in the form of financial ratios are utilised to assess the financial performance of the Shire.

To maintain comparability across the Industry, these ratios and their respective target ranges have been derived from the Department of Local Government, Sport and Cultural Industries Operational Guideline Number 18 - Financial Ratios and Regulation 50 of Local Government (*Financial Management*) Regulations 1996.

The Audit Report includes adverse trends in the Shire's financial performance for two of the ratios that do not meet these target levels.

Asset Sustainability Ratio

The Asset Sustainability Ratio is an approximation of the extent to which assets managed by a local government are being replaced as they reach the end of their useful lives. It is calculated by measuring capital expenditure on renewal or replacement of assets, relative to depreciation expense. Expenditure on new or additional assets is excluded. Depreciation expense represents an estimate of the extent to which the assets have been consumed during the accounting period.

The ratio is calculated using the following equation:

$$\frac{\text{Capital renewal and replacement expenditure}}{\text{Depreciation expense}}$$

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

Advanced Standard – 110% or greater

An advanced standard is met when ratio is greater than 110%. It indicates the Shire is investing in asset renewal/replacement to the degree that offsets the current consumption of its assets and provides for the effect of inflation.

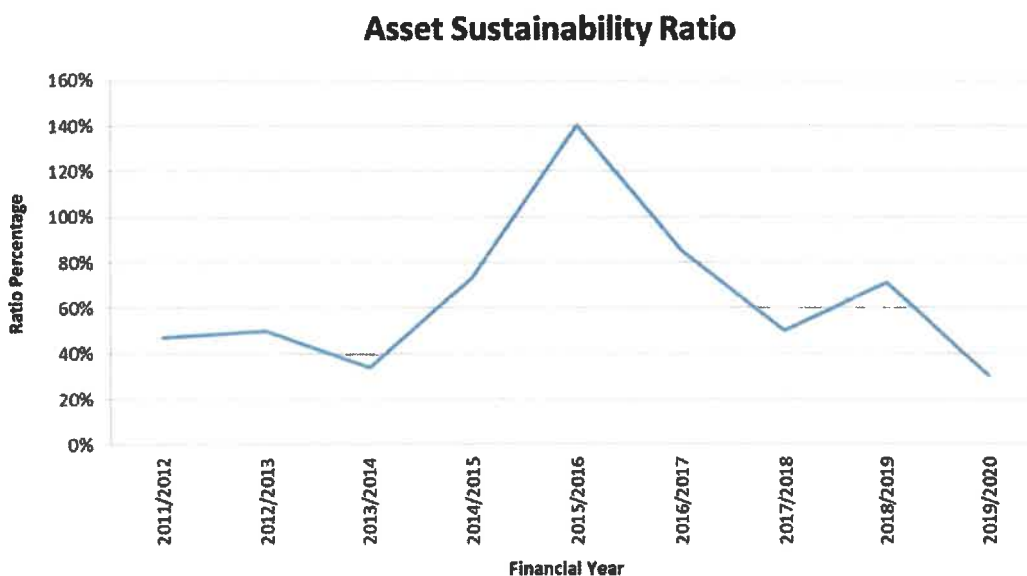
Basic Standard – between 90% and 110%

Basic Standard is met if asset sustainability ratio is between 90% and 110%.

Below Standard – lower than 90%

Standard is not met, when a ratio is less than 90% a higher risk is evident and indicates the Shire is having difficulty undertaking a sustained capital investment program sufficient to renew/replace assets.

The graph below tracks the performance of Council's Asset Sustainability Ratio since 2012. The ratio result varies from year to year depending on the capital works program delivered.



Further work is being planned in respect to the current assessment of asset remaining useful lives and residual values. These assessments will ensure Council is depreciating its assets at an appropriate rate. Any change in depreciation expense will directly impact the results of this ratio.

Apart from ensuring Council is depreciating its assets appropriately it is critical that all renewal and replacement expenditure for Council's assets is captured. Council has a number of bridges recognised in its asset register. The replacement value of these bridges is \$10,669,359 with an annual depreciation expense of \$178,596 (as reported in the 2019/20 financial statements). The majority of bridge renewal works are undertaken by Main Roads WA on behalf of the Shire. These works are generally funded via grant allocations from the Federal and State governments. Data regarding the scope and final value of works undertaken by Main Roads WA is generally not received for the portion of works funded by the State government. The result being Council may not be recognising the full value of renewal works being undertaken on its bridge assets resulting in a significant negative impact to the Asset Sustainability Ratio. This issue is currently being investigated by Administration to determine if this is a wide spread issue in the sector prior to identifying the need for any action to raise the issue with relevant state government ministers and departments.

Operating Surplus Ratio

A key indicator of a local government's financial performance is measured by the 'Operating Surplus Ratio'. 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.

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.

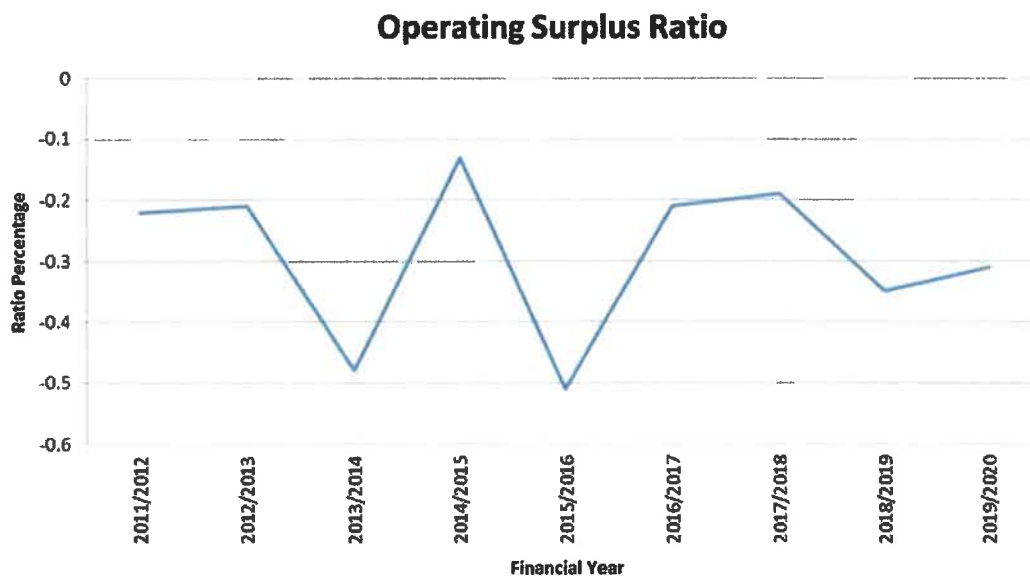
Basic Standard – between 1% and 15%

Basic Standard is met if the operating surplus ratio is between 0% 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 has long been argued by the local government sector that these grants are an integral component of revenue for local government and long term financial plans are predicted on receiving these funds. Removing this key source of revenue from the ratio calculation has a negative impact on the ratio and skews the result.

It is typical of a local government similar to the Shire of Bridgetown-Greenbushes 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 for renewal of its assets. As seen in the graph below the operating surplus ratio has traditionally had a negative result.



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

- 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.
- One off operating projects when the expenditure allocation has been carried over to the next financial year in part or in full.
- 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 Council 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, particularly considering the current economic circumstances. The measure could also be improved by Council reviewing its major operating cost centres, including employment costs, materials and contracts however this will almost certainly adversely impact the level of service which Council is able to deliver to the community.

3. Conclusion

The Asset Sustainability Ratio provides an indication from year to year on the level of expenditure being allocated to renewal of Council's existing assets. The Asset Sustainability Ratio is significantly affected by the amount of depreciation expense in each year. The accuracy of the amount of depreciation calculated continues to improve as the Shire's Asset Management Team refines the Shire asset database information on condition, remaining useful life and replacement dates. Council in common with most country local governments is reliant on grant funding to assist with asset renewals. The level of funding provided from one year to the next will vary and this directly impacts on the ratio's result.

The Operating Surplus Ratio requires Council 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.

Actions to be taken

There can be no short term actions taken without incurring significant negative impacts to the community through either unreasonable rate increases or a decrease in levels of service.

Council is very aware of its ratio performance in relation to benchmarks set by the Department. In December 2017 Council adopted the following 'Ratio Improvement Action Plan':

- A full review of Council's asset depreciation expenditure is undertaken. Specifically, a review of each individual Council asset (at component level) of its condition, useful life, remaining useful life and residual value.
- An assessment as to whether the Shire is revenue short or expenditure long by undertaking a comparison of neighboring and similar sized Shires in relation to the level of own source revenue (i.e. rates, fees and charges) compared to expenditure.
- Develop a policy to guide future Council decisions in relation to the allocation of funds to renewal works versus upgrade works.

- That various scenarios are modelled during the next review of Council's Long Term Financial Plan in relation to achieving minimum ratio benchmarks. The results of these scenarios to be workshopped with Council.

Items contained in the above plan are still being progressed and it has previously been acknowledged by Council and its Auditor that improving the performance of some ratios to meet the Department's benchmark is unlikely to occur in the short to medium term but Council should still demonstrate improvement towards achieving the benchmark through its integrated planning processes.

Council adopted a new Long Term Financial Plan (LTFP) in December 2020. During development of the plan consideration was given to ratio performance. The adopted LTFP demonstrates a steady improvement over the life of the plan in both the Asset Sustainability Ratio and Operating Surplus Ratio.

While an improvement in ratio performance is expected as actions contained in the Ratio Action Improvement Plan are progressed, it is expected that the Operating Surplus Ratio will remain at levels below the "standard" in the long term due to cost pressures and limited revenue sources.

The requirement to produce this report as an outcome of identified adverse trends in relation to ratio performance is likely, at least in the short to medium term, to be an annual process for the Shire of Bridgetown-Greenbushes.



Auditor General

INDEPENDENT AUDITOR'S REPORT

To the Councillors of the Shire of Bridgetown-Greenbushes

Report on the Audit of the Financial Report

Opinion

I have audited the annual financial report of the Shire of Bridgetown-Greenbushes which comprises the Statement of Financial Position as at 30 June 2020, the Statement of Comprehensive Income by Nature or Type, Statement of Comprehensive Income by Program, Statement of Changes in Equity, Statement of Cash Flows and Rate Setting Statement for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information, and the Statement by the Chief Executive Officer.

In my opinion the annual financial report of the Shire of Bridgetown-Greenbushes:

- (i) is based on proper accounts and records; and
- (ii) fairly represents, in all material respects, the results of the operations of the Shire for the year ended 30 June 2020 and its financial position at the end of that period in accordance with the *Local Government Act 1995* (the Act) and, to the extent that they are not inconsistent with the Act, Australian Accounting Standards.

Basis for Opinion

I conducted my audit in accordance with Australian Auditing Standards. My responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Report* section of my report. I am independent of the Shire in accordance with the *Auditor General Act 2006* and the relevant ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants* (the Code) that are relevant to my audit of the annual financial report. I have also fulfilled my other ethical responsibilities in accordance with the Code. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Emphasis of Matter – Basis of Accounting

I draw attention to Notes 1 and 11 to the annual financial report, which describes the basis of accounting. The annual financial report has been prepared for the purpose of fulfilling the Shire's annual financial reporting responsibilities under the Act. In respect of the comparatives for the previous year ended 30 June 2019, Regulation 16 of the Local Government (Financial Management) Regulations 1996 (Regulations), did not allow a local government to recognise some categories of land, including land under roads, as assets in the annual financial report. My opinion is not modified in respect of this matter.

Responsibilities of the Chief Executive Officer and Council for the Financial Report

The Chief Executive Officer (CEO) of the Shire is responsible for the preparation and fair presentation of the annual financial report in accordance with the requirements of the Act, the Regulations and, to the extent that they are not inconsistent with the Act, Australian Accounting Standards. The CEO is also responsible for such internal control as the CEO determines is necessary to enable the preparation of the annual financial report that is free from material misstatement, whether due to fraud or error.

In preparing the annual financial report, the CEO is responsible for assessing the Shire's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the State Government has made decisions affecting the continued existence of the Shire.

The Council is responsible for overseeing the Shire's financial reporting process.

Auditor's Responsibility for the Audit of the Financial Report

The objectives of my audit are to obtain reasonable assurance about whether the annual financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the annual financial report.

A further description of my responsibilities for the audit of the annual financial report is located on the Auditing and Assurance Standards Board website at https://www.auasb.gov.au/auditors_responsibilities/ar4.pdf. This includes the identification and assessment of the risk of material misstatement due to fraud arising from management override of controls. This description forms part of my auditor's report.

Report on Other Legal and Regulatory Requirements

In accordance with the Local Government (Audit) Regulations 1996 I report that:

- (i) In my opinion, the following material matters indicate significant adverse trends in the financial position of the Shire:
 - a. The Asset Sustainability Ratio as reported in Note 33 of the annual financial report has been below the Department of Local Government, Sport and Cultural Industries' standard for the past three financial years; and
 - b. The Operating Surplus Ratio as reported in Note 33 of the annual financial report has been below the Department of Local Government, Sport and Cultural Industries' standard for the past three financial years.
- (ii) All required information and explanations were obtained by me.
- (iii) All audit procedures were satisfactorily completed.
- (iv) In my opinion, the Asset Consumption Ratio and the Asset Renewal Funding Ratio included in the annual financial report were supported by verifiable information and reasonable assumptions.

Other Matter

The financial ratios for 2018 in Note 31 of the annual financial report were audited by another auditor when performing their audit of the Shire for the year ending 30 June 2018. The auditor expressed an unmodified opinion on the annual financial report for that year.

Matters Relating to the Electronic Publication of the Audited Financial Report

This auditor's report relates to the annual financial report of the Shire of Bridgetown-Greenbushes for the year ended 30 June 2020 included on the Shire's website. The Shire's management is responsible for the integrity of the Shire's website. This audit does not provide assurance on the integrity of the Shire's website. The auditor's report refers only to the annual financial report described above. It does not provide an opinion on any other information which may have been hyperlinked to/from this annual financial report. If users of the annual financial report are concerned with the inherent risks arising from publication on a website, they are advised to refer to the hard copy of the audited annual financial report to confirm the information contained in this website version of the annual financial report.



CARLY MEAGHER
ACTING SENIOR DIRECTOR FINANCIAL AUDIT
Delegate of the Auditor General for Western Australia
Perth, Western Australia
7 December 2020