

<b>10.1.6</b>	<b>AUDIT 30 JUNE 2018 – SIGNIFICANT MATTER RAISED</b>
<b>RESPONSIBLE OFFICER:</b>	Trish Standish – Manager of Finance and Administration
<b>REPORT AUTHOR:</b>	Trish Standish – Manager of Finance and Administration
<b>FILE REFERENCE:</b>	FM9
<b>APPLICANT:</b>	N/A
<b>DATE OF REPORT:</b>	1 July 2019
<b>ATTACHMENTS:</b>	Nil

**Purpose**

The purpose of this report is to provide the Council with a report addressing a matter identified as ‘significant’ in the 2017/2018 Audit Report, pursuant to section 7.12A of the Local Government Act 1995.

**Background**

Council adopted the Annual Financial Statements and the Office of the Auditor General (OAG) independent audit report for the year ending 30 June 2018 on 20 March 2019. Section 7.12A (4) (a) of the Local Government Act 1995 dictates the submission of a report to the Minister regarding the significant adverse trend noted by the OAG in their independent auditor’s report.

The OAG identified the Operating Surplus Ratio that has been below the Department of Local Government, Sport and Cultural Industries (DLGSCI) standard for the past three years as a significant adverse trend.

**Officers Comment**

The operating surplus ratio is a measure of the Shire’s ability to cover its operational costs and have revenues available for capital funding or other non-operating purposes. The calculation method is:

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

A basic standard is met between 0.01 and 0.15. An advanced standard is met if the ratio is greater than 0.15. Over the past eight years the Shire’s operating surplus ratio has been as follows:

2018	(0.52)
2017	(0.27)
2016	(0.73)
2015	0.08
2014	(0.24)
2013	(0.26)
2012	0.70
2011	0.62

Council will recall that Mr Paul Gilbert from Macleods Corporation Pty Ltd addressed this issue as part of his report after undertaking the Financial Management Review in January 2019.

The report states:

“Financial Ratios

*Council’s financial ratio performance generally exceeds the Local Government Departments expectations, we consider that the Shire has healthy financial operating ratios. Only the Operating Surplus Ratio and the Asset Sustainability Ratio do not meet with expectations and this is consistent with many other regional Councils illustrating an economic dependency on grants.*

*Both ratios are adversely impacted by the high level of non-cash depreciation expense, particularly as it relates to roads and bridges causing an operating deficit (despite an operating cash-flow surplus). We recommend that depreciation rates be reviewed.”*

This ratio is the most difficult to address, as it requires Council to ensure that its revenue sources grow at the same or a greater rate than its operating expenses, including depreciation. The introduction of fair value of all assets resulted in Council increasing the value of its assets which has caused a negative flow on effect to the amount of depreciation booked due to the increase in carrying values of assets.

It is well known that regional Councils struggle to fully cash fund asset depreciation as their revenue sources are limited. The only major source of funding that Council can control is rates. The challenge that faces Council is in order to achieve an operating surplus ratio result that is within the benchmarks established by the DLGSCI is striking a balance between how much of a rate burden should be placed on ratepayers and how much of a reduction in service levels should occur to contain rising operating expenses.

Whilst depreciation rates have been reviewed, it is quite possible that this ratio will remain at a level below the DLGSCI standard due to cost pressures and limited revenue sources.

**Statutory Environment**

The Local Government Act 1995 Section 7.12A states that:

“(4) The 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.
- (5) 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.”

**Policy Applicable – Implications**

There is no Council policy applicable to this report.

**Financial Implications**

There are no financial implications from this report.

### **Risk Implications**

The risks associated with matters in this report are:

- Errors, Omissions and Delays
- Failure to fulfil Statutory, Regulatory or Compliance Requirements

The **impact** of the risk is Non-Compliance

The **consequences** of these risks are considered to be Insignificant

The **likelihood** is Possible

Hence the **risk rating** is Low

Risk mitigation includes reporting to Council and the Department of Local Government Sport and Cultural Industries.

### **Strategic Community Plan Reference**

The 2017-2027 Shire of Cranbrook, Strategic Community Plan states that:

*Objective 4: Leadership - Demonstrate strong governance, leadership and organisational growth*

Outcome 4.1: Excellence in governance, compliance, regulation and reporting

Strategy 4.1.1: Maintain a high level of corporate governance, responsibility and accountability

### **Consultation**

Consultation was not required for this report.

### **VROC Implications**

There are no strategic VROC implications from this report

### **Voting Requirements**

Simple Majority

### **COMMITTEE RECOMMENDATION / COUNCIL DECISION**

**Motion 08072019**

**Moved Cr Denton, seconded Cr Fiegert that the Audit Committee recommends to the Council that this report be accepted and forwarded to the Minister.**

**Carried 7/0**