



# ADVERSE TREND REPORT 2020/21

## REPORT – 2020-2021 Significant Adverse Trend – Operating Surplus Ratio

Section 7.12A (4) of the Local Government Act 1995 requires a local government to prepare a report to address significant matters identified by the auditors in the audit report, stating what action has been taken or is intended to be taken in respect to each of the matters. The Shire of Cranbrook's Independent Auditor's Report for 2020-21 issued by the Office of the Auditor General (OAG), noted a significant adverse trend for the operating surplus ratio.

### Shire of Cranbrook – Operating Surplus Ratio

Operating Surplus Ratio  $\frac{\text{Operating Revenue MINUS Operating Expenditure}}{\text{Own Source Operating Revenue}}$

The operating surplus ratio measures a local government's ability to cover its operations (including depreciation expense) and still have revenue available for capital works and other purposes. A positive operating surplus ratio is considered by the Department of Local Government, Sport and Cultural Industries (the Department) as an indicator of long-term financial sustainability. The Shire's operating surplus ratio has experienced movement over the previous three years as below:

2019	2020	2021
(0.38)	(0.34)	(0.34)

The basic benchmark set by the Department for the operating surplus ratio is 0.01 – 0.15. Ratios higher than 0.15 are in the desirable benchmark range set by the Department. The Shire of Cranbrook has not met the benchmark for the last three years, resulting in the 'significant adverse trend' finding on the Shire's audit report.

### Explanation for Operating Surplus Ratio Not Meeting Benchmarks

The operating surplus ratio calculation excludes grants received to assist with capital works such as Roads to Recovery (R2R) and Regional Road Group (RRG), but includes depreciation expense. Depreciation expense is rarely funded in full by rural local governments such as the Shire of Cranbrook. Grant funding such as R2R and RRG contribute to asset renewals and in effect offset the operating losses arising from depreciation expense.

### Actions Proposed to Address the Operating Surplus Ratio

To improve the operating surplus ratio the Shire could increase rates or fees and charges, which would effectively result in over rating the community when considering the ongoing capital grants received by the Shire and must also be balanced with the community's capacity to pay. The ratio could also be improved by reviewing its operations and reducing expenditure, however this will almost certainly adversely impact the level of service which the Shire is able to deliver to the community.

As a result, the Shire considers the benchmark for the operating surplus ratio to be flawed for a shire receiving non-operating grants for the renewal of assets, and it does not intend to take action to increase revenue above a level which will result in the community being overrated when considering expected and ongoing non-operating grants for asset renewals, or reducing expenditure and subsequently services to its community.

The operating surplus ratio and the financial performance of the Shire of Cranbrook will continue to be reviewed through ongoing monitoring of depreciation expense and financial reporting to Council.