



PUBLIC ATTACHMENTS

Special Council
Meeting 3.30pm

16 August 2021



Audit Findings for the
Financial Year Ended 30th June 2020

Report on Significant Matter

Operating Surplus Ratio

Current Ratio

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Background

The Shire of Victoria Plains (Shire) is required to prepare an audited Annual Financial Report each year under the *Local Government Act 1995* (the Act).

The Shire's auditor is the Office of the Auditor General (OAG). The OAG's 30 June 2020 Audit Report for the Shire is attached at Appendix 1.

A key audit requirement is the responsibility of the Auditor to identify any adverse (significant) financial trends.

Regulation 50 of the *Local Government (Financial Management) Regulations 1996* requires the inclusion of seven ratios in the Annual Financial Report.

50 Financial ratios to be included in annual financial report

(1) *The annual financial report is to include, for the financial year covered by the annual financial report and the 2 preceding financial years –*

- (a) *the current ratio; and*
- (b) *the asset consumption ratio; and*
- (c) *the asset renewal funding ratio; and*
- (d) *the asset sustainability ratio; and*
- (e) *the debt service cover ratio, and*
- (f) *the operating surplus ratio; and*
- (g) *the own source revenue coverage ratio.*

For the financial year ended 30 June 2020, the OAG has reported a significant adverse trend in the Operating Surplus Ratio and Current Ratio for the Shire. It has been noted that: the Operating Surplus Ratio and Current Ratio have not met the Department of Local Government, Sport and Cultural Industries (DLGSCI) standard as set out in *Operational Guideline Number 18 Financial Ratios*.

The Auditor General reported the following:

Report on Other Legal and Regulatory Requirements

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

In my opinion, the following material matters indicate significant adverse trends in the financial position of the Shire:

- a. The **Operating Surplus Ratio** as reported in Note 33 of the annual financial report is below the Department of Local Government, Sport and Cultural Industries' standard for the last three financial years.
- b. The **Current Ratio** as reported in Note 33 of the annual financial report is below the Department of Local Government, Sport and Cultural Industries' standard for the last two financial years with the current year also being below the previous year.

Note:

The OAG made a significant finding in relation to the Operating Surplus ratio for the financial year ended 30 June 2019 i.e., the Operating Surplus Ratio is below the DLGSCI standard for the past 3 years.

Five Year Trend

The following table presents the financial ratios for the Shire against DLGSCI benchmarks for the past five years. Within this table the two ratios of concern have been highlighted:

| | Standard | 2020 | 2019 | 2018 | 2017 | 2016 | 5 Year Average |
|-----------------------------------|----------|--------|--------|--------|--------|--------|----------------|
| Current ratio | ≥ 1.00 | 0.94 | 0.99 | 1.26 | 1.67 | 1.85 | 1.78 |
| Asset consumption ratio | ≥ 0.50 | 0.70 | 0.72 | 0.68 | 0.97 | 0.98 | 0.81 |
| Asset renewal funding ratio | ≥ 0.75 | 0.96 | 1.12 | 0.84 | 0.94 | 1.03 | 0.98 |
| Asset sustainability ratio | ≥ 0.90 | 0.35 | 0.86 | 0.71 | 1.25 | 0.80 | 1.02 |
| Debt service cover ratio | ≥ 2.00 | 8.23 | (8.54) | 2.90 | 13.92 | 4.48 | 4.20 |
| Operating surplus ratio | ≥ 0.01 | (1.16) | (1.60) | (0.60) | (0.32) | (0.86) | (0.91) |
| Own source revenue coverage ratio | ≥ 0.40 | 0.38 | 0.34 | 0.50 | 0.51 | 0.46 | 0.44 |

Operating Surplus Ratio

As per *Local Government Operational Guidelines No 18 – Financial Ratios*, the Operating Surplus Ratio measure is described as:

| Operating Surplus Ratio | |
|--------------------------------|---|
| Operating Surplus Ratio = | $\frac{(\text{Operating Revenue MINUS Operating Expense})}{\text{Own Source Operating Revenue}}$ |
| Purpose: | This ratio is a measure of a local government's ability to cover its operational costs and have revenues available for capital funding or other purposes. |
| Standards: | Basic Standard between 1% and 15% (0.01 and 0.15) Advanced Standard > 15% (>0.15). |
| Definitions: | |
| 'Operating Revenue' | Means the revenue that is operating revenue for the purposes of the AAS, excluding grants and contributions for the development or acquisition of assets. |
| 'Operating Expense' | Means the expense that is operating expense for the purposes of the AAS. |
| 'Own Source Operating Revenue' | Means revenue from rates and service charges, fees and user charges, reimbursements and recoveries *, interest income and profit on disposal of assets. |

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.

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.

A negative ratio indicates the percentage increase in total own source revenue (principally rates) that would have been required to achieve a break-even operating result.

The DLGSCI considers a "basic" standard to be between 1% and 15% and an "advanced" standard with a measure of over 15%.

Current Ratio

As per *Local Government Operational Guidelines No 18 – Financial Ratios*, the Current Ratio measure is described as:

| Current Ratio | |
|---|---|
| Current Ratio = | $\frac{\text{(Current Assets MINUS Restricted Assets)}}{\text{(Current Liabilities MINUS Liabilities Associated with Restricted Assets)}}$ |
| Purpose: | This is a modified commercial ratio designed to focus on the liquidity position of a local government that has arisen from past year's transactions. |
| Standards | <p>The standard is not met if the ratio is lower than 1:1 (less than 100%) The standard is met if the ratio is greater than 1:1 (100% or greater) A ratio less than 1:1 means that a local government does not have sufficient assets that can be quickly converted into cash to meet its immediate cash commitments. This may arise from a budget deficit from the past year, a Council decision to operate an overdraft or a decision to fund leave entitlements from next year's revenues.</p> |
| Definitions: | |
| 'Current Assets' | Means the total current assets as shown in the balance sheet. |
| 'Current Liabilities' | Means the total current liabilities as shown in the balance sheet. |
| 'Restricted Asset' | Means an asset the use of which is restricted, wholly or partly, by a law made or a requirement imposed outside of the control of the local government, where the restriction is relevant to assessing the performance, financial position or financing and investment of the local government. This includes all section 6.11 cash reserves as these are restricted by the Act '... by a law made ...', unspent specific grants and other restricted cash identified by the local government, as these are restricted by '... a requirement imposed outside of the control of the local government ...' |
| 'Liabilities Associated with Restricted Assets' | <p>Means the lesser value of a current liability or the cash component of restricted assets held to fund that liability. Commonly this is the cash reserve for long service leave, annual leave and other employee entitlements. Ideally the cash reserve amount should be the same as the provision amount but this is rarely the case.</p> <ul style="list-style-type: none"> • Only make a deduction if there is a cash reserve. • If the cash reserve is greater than the provision amount, only deduct the amount of the provision. • If the provision amount is greater than the cash reserve, only deduct the amount of the cash reserve. • If the cash reserve is for the purpose of long service leave (or other specific leave) then only adjust for that specific leave provision and not the total of all leave provisions. |

Liquidity refers to how quickly and cheaply an asset can be converted into cash. A local government's liquidity is measured by the 'Current Ratio'. This ratio provides information on the ability of a local government to meet its short-term financial obligations out of unrestricted current assets.

A ratio of less than one means that the local government's current unrestricted liabilities exceed its current unrestricted assets which can impact on the local governments ability to meet its obligations.

Report per Section 7.12A(4)(a) of the Local Government Act 1995

S7.12A of the Act requires the following relating to significant matters raised in the audit report

(4) 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.

Council considered a recommendation from the Shire Audit Committee and resolved on 28 July 2021 the following response in accordance with s7.12A(4)(a) of the Act.

Purpose of Report

To report in compliance with s7.12A of the *Local Government Act 1995* relating to two significant matters raised in the 2020 audit report.

Significant Matters Identified by OAG

In my opinion, the following material matters indicate significant adverse trends in the financial position of the Shire:

- a. The Operating Surplus Ratio as reported in Note 33 of the annual financial report is below the Department of Local Government, Sport and Cultural Industries' standard for the last three financial years.
- b. The Current Ratio as reported in Note 33 of the annual financial report is below the Department of Local Government, Sport and Cultural Industries' standard for the last two financial years with the current year also being below the previous year.

Note:

The OAG made a significant finding in relation to the Operating Surplus ratio for the financial year ended 30 June 2019 i.e., the Operating Surplus Ratio is below the DLGSCI standard for the past 3 years.

Implications

Operating Surplus Ratio

If a Local Government runs ongoing under-lying operating deficits, it needs to recognise longer-term implications. Not addressing ongoing deficits is likely to mean that future Councils will struggle to be able to accommodate asset renewal needs and that service levels will decline over time. It is acknowledged that a trending reduction in the operating deficit is necessary for improved sustainable financial health of the Shire.

Current Ratio

Although widely regarded as a measure of short-term debt paying ability, the current ratio must be interpreted with great care. A declining ratio may be a sign of a significant adverse trend in the financial position of the Shire; however, it is important to look at the individual assets and liabilities involved in the calculation.

Management Comment

The Shire is continuing to transition towards improved long-term financial sustainability. This is outlined in the Strategic Resource Plan (SRP) adopted at the 12 August 2019 Special Council Meeting. The SRP contains both the Long-Term Financial Plan and the Asset Management Plan for the Shire.

Operating Surplus Ratio

The SRP forecasts rate revenue along with fees and charges to increase by 7.0% (CPI 2.0% + 5%) from year 1 to year 5 of the Plan, with a 3.0% increase (CPI 2.0% + 1%) for the remaining term of the Plan. These increases are to assist in the long-term financial stability of the Shire and to maintain the level of services to the community.

The forecast increases in rate revenue and fees and charges result in an improvement to the Operating Surplus ratio from (0.66%) in 2020 to (0.31%) in 2034.

Whilst it is acknowledged that the forecast Operating Surplus ratio remains below the DLGSCI benchmark, the 2020 ratio of (1.16) is a significant improvement from the 2019 ratio of (1.60).

Current Ratio

The 2020 current ratio is impacted by the recognition of contract liabilities of \$209,544 in relation to the implementation of AASB 15 and AASB1058 which came into effect for the year ended 30 June 2020.

The contract liabilities relate to incomplete projects at year end.

The recognition of these liabilities led to a deterioration in the current ratio as noted by the auditor. Had the contract liabilities not been recognised, the current ratio would have met the DLGSCI benchmark (estimated ratio would have been 1.23).

Action Taken or Intended to be Taken

The following Integrated Plans have been adopted by Council:

- Strategic Community Plan (28 March 2018);
- Strategic Resource Plan (12 August 2019)
- Workforce Plan (12 August 2019)
- Corporate Business Plan (12 August 2019)

The Integrated plans include increases to Rates and Fees and Charges which will improve the Own Source Revenue Ratio over the course of the Strategic Resource Plan.

The Shire will continue to monitor its Current Ratio and consider if any factors impacting the ratio represent a significant adverse trend.

Proposed Completion Date

Council is committed to the following;

1. Reduction of the Operating Deficit; and
2. Monitoring the Operating Surplus Ratio for significant adverse trends.

It is expected that the implementation of the strategies outlined in the Strategic Resource Plan with respect to Rates and Fees and Charges increases will result in improvements in the Operating Surplus Ratio over the duration of the Strategic Resource Plan. The Shire will continue to monitor its Current Ratio and consider if any factors impacting the ratio represent a significant adverse trend.

A copy of the Forecast Financial Ratios from the Shire's Strategic Resource Plan is provided in Appendix 2.

Recommendation

That Council is committed to a trending improvement in the Operating Surplus Ratio and the long term sustainable financial health of the Shire through continued implementation and funding of its Integrated Financial Planning Framework. Also, that it will continue to monitor the Shire's Current Ratio.

Appendix 1: OAG 30 June 2020 Audit Report



Auditor General

INDEPENDENT AUDITOR'S REPORT

To the Councillors of the Shire of Victoria Plains

Report on the Audit of the Financial Report

Opinion

I have audited the annual financial report of the Shire of Victoria Plains 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 Victoria Plains:

- (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 describe the basis of accounting. The annual financial report has been prepared for the purpose of fulfilling the Shire's financial reporting responsibilities under the Act, including the Local Government (Financial Management) Regulations 1996 (Regulations). My opinion is not modified in respect of these matters:

- (i) Regulation 17A requires a local government to measure vested improvements at fair value and the associated vested land at zero cost. This is a departure from AASB 16 *Leases* which would have required the entity to measure the vested improvements also at zero cost.
- (ii) In respect of the comparatives for the previous year ended 30 June 2019, Regulation 16 did not allow a local government to recognise some categories of land, including land under roads, as assets in the annual financial report.

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 Operating Surplus Ratio as reported in Note 33 of the annual financial report is below the Department of Local Government, Sport and Cultural Industries' standard for the last three financial years.
 - b. The Current Ratio as reported in Note 33 of the annual financial report is below the Department of Local Government, Sport and Cultural Industries' standard for the last two financial years with the current year also being below the previous year.
- (ii) The following material matters indicating non-compliance with Part 6 of the *Local Government Act 1995*, the Local Government (Financial Management) Regulations 1996 or applicable financial controls of any other written law were identified during the course of my audit:
 - a. For approximately 15% of purchase transactions we sampled, there was inadequate or no evidence that a sufficient number of quotations were obtained to test the market, and no documentation to explain why other quotes were not sought.
 - b. For approximately 17% of purchase transactions we sampled, the purchase orders raised were dated after the dates of the corresponding supplier invoices.
These practices increase the risk of fraud or favouritism of suppliers, not obtaining value for money in procurement, and inappropriate or unnecessary purchases.
- (iii) All required information and explanations were obtained by me.
- (iv) All audit procedures were satisfactorily completed.
- (v) 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 33 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 Victoria Plains 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.



ALOHA MORRISSEY
ASSISTANT AUDITOR GENERAL FINANCIAL AUDIT
Delegate of the Auditor General for Western Australia
Perth, Western Australia
25 February 2021

Appendix 2: Strategic Resource Plan 2019 2034 Extract – Forecast Financial Ratios

| | Target Range | | Average | 2019-20 | 2020-21 | 2021-22 | 2022-23 | 2023-24 | 2024-25 | 2025-26 | 2026-27 | 2027-28 | 2028-29 | 2029-30 | 2030-31 | 2031-32 | 2032-33 | 2033-34 |
|-----------------------------------|--------------|-----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|
| | Basic | Advanced | | | | | | | | | | | | | | | | |
| LIQUIDITY RATIOS | | | | | | | | | | | | | | | | | | |
| Current Ratio | > 1.00 | > 1.20 | 0.69 | 0.66 | 0.66 | 0.68 | 0.68 | 0.68 | 0.67 | 0.68 | 0.69 | 0.69 | 0.70 | 0.73 | 0.73 | 0.73 | 0.73 | 0.73 |
| OPERATING RATIOS | | | | | | | | | | | | | | | | | | |
| Operating Surplus Ratio | > 1.00% | > 15.00% | (40.97%) | (65.58%) | (58.96%) | (52.58%) | (46.60%) | (40.45%) | (39.28%) | (38.24%) | (37.16%) | (36.05%) | (34.98%) | (34.91%) | (33.71%) | (32.72%) | (32.34%) | (30.99%) |
| Own Source Revenue Coverage Ratio | > 40.00% | > 60.00% | 57.26% | 48.38% | 50.41% | 52.54% | 54.71% | 57.11% | 57.59% | 58.04% | 58.51% | 59.01% | 59.50% | 59.66% | 60.19% | 60.68% | 60.94% | 61.58% |
| BORROWINGS RATIOS | | | | | | | | | | | | | | | | | | |
| Debt Service Cover Ratio | > 3 | > 5 | 16.18 | 4.09 | 4.60 | 5.99 | 9.21 | 11.24 | 11.84 | 12.48 | 14.77 | 17.79 | 18.75 | 67.23 | - | - | - | - |
| FIXED ASSET RATIOS | | | | | | | | | | | | | | | | | | |
| Asset Sustainability Ratio | > 90.00% | > 110.00% | 61.01% | 85.15% | 30.69% | 49.97% | 46.24% | 55.08% | 51.14% | 54.95% | 51.08% | 78.59% | 71.52% | 112.26% | 50.12% | 56.31% | 50.50% | 71.51% |
| Asset Consumption Ratio | > 50.00% | > 60.00% | 67.08% | 72.54% | 71.57% | 70.63% | 69.75% | 69.05% | 68.39% | 67.65% | 66.89% | 66.32% | 65.64% | 65.14% | 64.36% | 63.54% | 62.70% | 62.00% |
| Asset Renewal Funding Ratio | > 75.00% | > 95.00% | 68.24% | 111.66% | 96.37% | 51.00% | 41.57% | 40.59% | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |