



SHIRE OF DUMBLYUNG

ORDINARY MEETING OF COUNCIL MINUTES

18 FEBRUARY 2021

10.4 MANAGER OF FINANCE OFFICER REPORT

10.4.9 SIGNIFICANT ADVERSE TREND

LOCATION/ADDRESS:	N/A
NAME OF APPLICANT:	Shire of Dumbleyung
FILE REFERENCE:	0006 – Financial Management/Audit Reports
AUTHOR:	Manager of Finance
DISCLOSURE OF INTEREST:	Nil
DATE:	22 December 2020
ATTACHMENT:	Report on Significant Adverse Trend
VOTING REQUIREMENT:	Absolute Majority

OFFICER RECOMMENDATION/COUNCIL RESOLUTION:

Motion 2021/1016

That Council receives the Report on Significant Adverse Trends and continues to investigate strategies to improve the Operating Surplus Ratio.

Moved Cr Knight

Seconded Cr Watkins

Carried 8/0

Note: Council would like it noted that once again country councils are disadvantaged by this ratio.

PURPOSE

To consider the significant adverse trend identified in the audit of the financial statements for the year ended 30 June 2020.

STRATEGIC IMPLICATIONS

Nil

STATUTORY ENVIRONMENT AND POLICY IMPLICATIONS

Local Government Act 1995 Section 7.12A

FINANCIAL AND STAFFING IMPLICATIONS

Nil

RISK IMPLICATIONS

Low

COMMUNITY ENGAGEMENT AND CONSULTATION

Nil

BACKGROUND

Section 7.12A(4) of the *Local Government Act 1995* requires local governments to report on matters identified as significant by the auditor and to indicate what action(s) the local government has taken or intends to take in respect of the matters.

The Office of the Auditor General identified as part of its audit of the Shire's financial statements for the year ended 30 June 2020, that the Operating Surplus Ratio was showing a significant adverse trend and had not

met the minimum standard as set by the Department of Local Government, Sport and Cultural Industries (the Department).

COMMENT

The Operating Surplus Ratio is a measure of a local government's ability to cover its operation costs and have revenue available for capital funding or other purposes. It is calculated by dividing the difference between operating revenue (less grants and contributions for the development or acquisition of assets) and operating expense by the own source operating revenue (revenue from rates and service charges, fees and charges, reimbursements and recoveries, interest income and profit on disposal of assets).

Most country local governments struggle to fully fund asset depreciation from its own revenue sources and there is reliance of external grant funding to assist with asset renewal. The main ways to improve this ratio could include increasing rates substantially or reducing operating expenditure. Both measures could have adverse effects on the community; increasing rates may render people unable to pay, while reducing operating expenditure may result in reducing services that the community values.

The Office of the Auditor General have advised they are in discussion with the Department as to the appropriateness of the benchmarks of the required financial ratios. No changes have been made thus far and investigations into improving the Shire's Operating Surplus Ratio are ongoing.



SHIRE OF DUMBLEYUNG

REPORT ON SIGNIFICANT ADVERSE TREND

1. Background

Under the *Local Government Act 1995* the Shire of Dumbleyung 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 16 December 2020.

The *Local Government (Audit) Regulations 1996* section 10 (3) requires the auditor to identify any financial trends which it considers adverse and of concern. For the year ended 30 June 2020, the Auditor General has identified a significant adverse trend in relation to the financial position of the Shire. The Shire of Dumbleyung has not met the minimum standard as set by the Department of Local Government, Sport and Cultural Industries (the Department) for the Operating Surplus Ratio for the past three 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 the 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 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

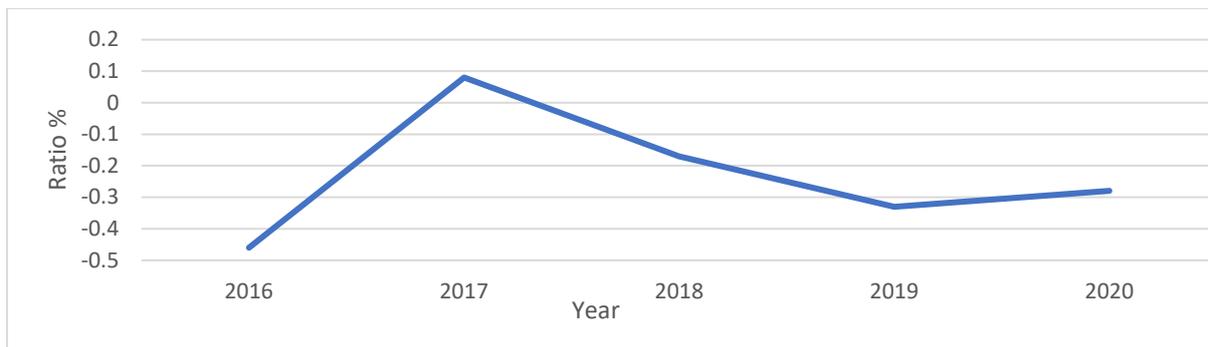
A ratio of greater than 15% indicates the Shire is providing a strong operating surplus which will give flexibility in the future in relation to operational service levels and asset base.

Basic Standard – between 1% and 15%

Below Standard – 0% or less

The Operating Surplus Ratio calculation excludes grants received to assist with capital works but includes depreciation expense. It is 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 these funds from the ratio calculation has a negative impact on the ratio and skews the result.

It is typical of local governments like the Shire of Dumbleyung to have an Operating Surplus Ratio that does not meet minimum requirements. This result reflects a reliance on sources of funding other than the Shire's own source funds such as rates, to be sustainable. As seen below, the Shire's ratio has only met the basic standard once in the last five years, showing a declining trend with small improvement in 2019/20.



Numerous 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 eg. 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 Shire 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. The measure could also be improved by the Shire reviewing its major operating cost centres, including employment costs, materials and contracts however this will almost certainly adversely impact the level of service which the Shire is able to deliver to the community.

The current ratio benchmarks adopted by the Department is a "one size fits all" approach. It is understood most rural local governments have not had an Operating Surplus Ratio that met the standards set by the Department, and there has been an indication by the Auditor General that this benchmark may need review.

3. Conclusion

The Operating Surplus Ratio requires the Shire 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.

The Shire is very aware of its ratio performance in relation to benchmarks set by the Department and advises that steps will be taken as far as practicable to remedy this adverse trend.