Appendix 3

BUNBURY HARVEY
REGIONAL COUNCIL
HARVESTING RESOURCES FROM YOUR WASTE

Report Addressing the 2019/20 Annual Financial Report Audit Findings

Summary

The Auditor General in the Auditor's Report for the 2019/20 financial year has identified that the Assets Sustainability Ratio and Operating Surplus Ratio is below the Department of Local Government, Sport and Cultural Industries (DLGSCI) standard for the past 2 to 3 years respectively.

The Local Government Act, Section 7.12A(4) requires local governments to examine the audit report it receives and implement appropriate action in respect to the significant matters raised. A report addressing the significant matters identified in the audit report must be prepared and then considered by the Audit Committee before being adopted by Council.

This report has been prepared to meet the above requirements of the Local Government Act.

Requirement to Report on Significant Audit Findings

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.*

Significant Matters Identified by the Auditor General

The Audit Report prepared by the Auditor General on the 2019/20 Annual Financial Statements identified the following significant adverse trend:

(a) The Asset Sustainability Ratio as reported in Note 25 of the annual financial report is below the Department of Local Government, Sport and Cultural Industries standard for the past 2 financial years

(b) The Operating surplus ratio as reported in Note 25 of the financial report is below the Department of Local Government, Sport and Cultural Industries (DLGSCI) standard of for the past 3 financial years

Implications

The implications to the Council's financial position are:

Asset Sustainability Ratio:

$$\text{Asset Sustainability Ratio} = \frac{\text{Capital Renewal and Replacement Expenditure}}{\text{Deprecation}}$$

This ratio measures the extent to which assets are being renewed or replaced compared to the amount consumed (i.e. depreciated).

While there is no short-term impact, should this trend continue in the long term there is a risk that the condition of assets will deteriorate to the point that they do not adequately meet the needs of the council. This is due to not providing enough investment into the renewal or replacement of assets, compared to the rate they are wearing out.

Operating Surplus Ratio:

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

This ratio measures the local government's ability to cover its operational costs and have revenues available for capital funding and other purposes.

As the Council's operational costs (including depreciation) are greater than the operating revenues, the ratio is below zero and does not achieve the Department's benchmark. In the long term an ongoing operating deficit negatively impacts the Council's funding capacity for either capital expenditure and being able to set aside funds into reserves.

Officer Comments

The Auditor General's Report has not identified any non-compliance with the Local Government Act or Australian Accounting Standards in the 2019/20 Annual Financial Report; but does identify two ratios that are below a benchmark used as a guide by the Department of Local Government, Sport and Cultural Industries.

The following is the trend on both ratios from 2017/18 to the 2020/21 Budget:

Ratio	DLGSCI Target	2021 Budget	2020	2019	2018
Asset Sustainability	Greater than 0.80	1.17	0.65	0.57	2.43
Operating Surplus	Greater than Zero	(0.16)	(0.16)	(0.16)	(0.25)

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Note:

Asset Sustainability Ratio
The Asset Sustainability Ratio budgeted for 2021 of 1.17 meets the DLGSCI standard of being greater than 0.80.

Operating Surplus Ratio
Expenditure on site rehabilitation for the last 3 years has been funded from reserves which were built up in previous years by Council and can distort the Operating Surplus Ratio. Site rehabilitation expenditure is not a cost directly related to the current year only and reflects the cost of operations over many years. It is noted that if this site rehabilitation expenditure is removed from operating expenses, the operating surplus is above the Department of Local Government, Sport and Cultural Industries (DLGSCI) standard of zero for the last three years.

When site rehabilitation expenditure is excluded from the ratio calculation the above ratio would meet the DLGSCI standard of greater than zero:

Adjusted Ratio	2021 Budget	2020	2019	2018
Operating Surplus	0.07	1.07	0.94	0.89

Action Taken or Intended to be Taken

To improve these ratio's the Council needs to:

Asset Sustainability Ratio -	Allocate more capital expenditure on the renewal or upgrade of existing assets.
Annual Operating Surplus Ratio -	Either reduce operating expenditure and/or increase operating revenue.

With careful financial management, relying on modest and affordable fee increases, management's continuous review of operational expenditure to ensure value for money and achieving savings through operational efficiencies and investing into the renewal and/or upgrade of assets, these ratio's will in the long term forecasts either match or exceed the Department's benchmarks.