

6.5 OPERATING SURPLUS RATIO BELOW THE DEPARTMENT STANDARD AS IDENTIFIED IN THE AUDIT REPORT – 2020/21

Location/Address: Shire of Mingenew
Name of Applicant: Shire of Mingenew
Disclosure of Interest: Nil
File Reference: FM.AUD.20.21
Date: 6 December 2021
Author: Nils Hay, Chief Executive Officer
Voting Requirement: Simple Majority

Summary

In the audit report by the Auditor General for the year ended 30 June 2021, a “matter indicating significant adverse trends” was identified: that the Operating Surplus Ratio of the Shire has been below the standard of the Department of Local Government (DLGSC) for the past three years. This report seeks to note the issue raised by the auditors in the Audit Report of the Shire for 2020/21 and identify what is being done to address it.

Related Documents

Audit Report 2020/21

OFFICER RECOMMENDATION AND COMMITTEE RECOMMENDATION TO COUNCIL – ITEM 6.5

MOVED: Cr GJ Cosgrove

SECONDED: Cr AR Smyth

That the Audit & Risk Committee recommends to Council that it receives this report in regard to the material matter raised in the Audit Report for 2020/21 – Operating Surplus Ratio below Department of Local Government, Sport and Cultural Industries’ standard for the past three years.

CARRIED: 3/0

Committee Comment

A correction was noted for the table provided below showing the comparison for the Operating Surplus Ratio that the Shire of Mingenew’s ratio is -0.40 for 2021 (not -0.63 as shown).

Background

In the Audit Report from the Auditor General for the year ended 30 June 2021 there was a matter identified: that the Operating Surplus Ratio of the Shire is below the standard of the Department of Local Government (DLGSC) and has been for the last three years. The Shire was advised by Contract Auditors, Nexia, on 6 December 2021, that there was no requirement to respond to this finding – but that option existed to do so.

To that end, a report has been prepared for the Audit and Risk Committee and Council's endorsement before forwarding a copy to the OAG and Department of Local Government.

This finding has been repeated for several years due the fundamental nature of the Shire’s funding structure.

Comment

The Shire realises that this ratio shows a negative value once again, however, Local Governments such as the Shire of Mingenew rely on capital grant funding to sustain them, as such it is incredibly difficult to achieve an operating surplus in any given year. In comparing the Shire's Operating Surplus Ratio with other nearby Shires, it can clearly be seen that the other Shires face the same issue (please see comparison table below):

Operating Surplus Ratio	2021	2020	2019
Shire of Mingenew	-0.63*	-0.57	-0.32
Shire of Morawa	TBC	-0.51	-0.32
Shire of Coorow	TBC	-1.00	-0.98
Shire of Carnamah	TBC	-0.25	-0.63
Standard as per DLG	0.01 to 0.15	0.01 to 0.15	0.01 to 0.15

*see Committee Comment above – correction to -0.40

In order to address this adverse ratio, the Shire will continue to review its operating income and expenditure and attempt to, where possible, reduce the difference between operating income and operating expenditure. To achieve this, the Shire will review its depreciation charge (which makes up 44% of operating expenditure on its own), review its annual rates increases and review its Fees & Charges. It will also investigate other potential revenue streams and the reliance on capital grant funding, noting that both of these avenues are incredibly difficult to make material inroads into.

For a Shire the size of Mingenew, increasing revenue through raising rates, fees and charges is not a realistic or sustainable way to address this ratio due to the relatively small amounts involved. It requires fundamental changes to the way that local government is funded (increasing operational grants rather than capital grants) for us to be in a position to meet the DLG Standard for this ratio. WALGA has a Working Group (of which the Shire of Mingenew is a member) lobbying for change in the legislated Ratios in order to make them more relevant, and the recent Local Government Act Reform package released by the Department of Local Government in November 2021 flags the rationalisation of ratios as a desired outcome of legislative reform.

As always, we would be happy to receive suggestions from our auditors as to how we can more effectively manage these issues to try to improve ratio performance. We would be particularly interested in other models that similar local governments are successful employing which could potentially be adapted for our operating environment.

Statutory Environment

Whilst section 7.12A(4) of the Local Government Act 1995 sets out the requirements of addressing any matters identified as significant by the auditor in the audit report, it should be noted that this matter has not been raised as a significant matter with reference to the Local Government Act 1995.

Policy Implications

Council Policy 1.3.4 Significant Accounting Policies.

Financial Implications

There are no direct financial implications, but there may be financial implications in the future, depending on what actions are taken to address this ratio.

Strategic Implications

Strategic Community Plan;

1.2.1 Manage organisation in a financially sustainable manner.

1.2.3 Provide sound corporate governance of Shire and create an attractive work environment.

1.3.1 Provide a high level of compliance with external regulation, in a resource efficient manner

- 10.1.2 2020/21 FINAL AUDIT, ANNUAL REPORT AND ANNUAL MEETING OF ELECTORS
- 10.1.3 RFT2 – 2021/22 GRADER TENDER – NON-COMPLIANCE WITH CEO DELEGATION
- 10.1.4 AUDIT & RISK COMMITTEE INDEPENDENT MEMBER SELECTION
- 10.1.5 SHIRE OF MINGENEW INTERNAL AUDIT PLAN – FLEET MANAGEMENT UPDATE
- 10.1.6 OPERATING SURPLUS RATIO BELOW THE DEPARTMENT STANDARD AS IDENTIFIED IN THE AUDIT REPORT – 2020/21
- 10.1.7 REVIEW OF SHIRE OF MINGENEW RISK REGISTER 2021

OFFICER RECOMMENDATION AND COUNCIL DECISION – ENBLOC ITEM 10.1.2 – 10.1.7 – RESOLUTION# 03151221

MOVED: Cr HR McTaggart

SECONDED: Cr CV Farr

10.1.1 That Council receives the Minutes of the Shire of Mingenew Audit & Risk Committee meeting held 10 December 2021.

10.1.2 That Council

1. Accepts the 2020/21 Draft Annual Report as attached, incorporating the Annual Financial Report and Independent Auditors Report as presented at the meeting (authorising the CEO to make minor corrections and amendments to the final document prior to publishing);
2. Notes the Auditor's finding in regard to the incorrect depreciation on infrastructure assets as noted in the Management Letter as a "significant risk", and the management response;
3. Holds its Annual Meeting of Electors on Monday, 7 February 2022 at 5:30pm to discuss the contents of the annual report and any other matters, in accordance with s5.27 of the *Local Government Act 1995* and Regulation 15 of the *Local Government (Administration) Regulations 1996*.

10.1.3 That Council notes:

1. The non-compliance with Council's delegation to the CEO for accepting and rejecting tenders (CD25), in relation to the Request for Tender for the Grader (RFT2 – 2021/22 Grader), and
2. The actions taken improve internal procedures for tendering and procurement to mitigate any future risk of the error occurring again, including:
 - a) the development of a Procurement Workflow and Tender Checklist (attached)
 - b) the development of templates relating to tendering and procurement activities.

10.1.4 That Council:

1. Notes that Expressions of Interest were called via state-wide and local public notice; and
2. Endorses Ms. Jane Bagshaw's application to join the Shire of Mingenew's Audit and Risk Committee as an independent member; and
3. Appoints, by Absolute Majority, Ms. Bagshaw to the Shire of Mingenew Audit and Risk Committee for one year, with an option to extend for a further two years.

10.1.5 That Council:

1. Receives the Fleet Management Internal Audit Report Update as per Item 3 audit risk theme '1. Asset Management and 2. Misconduct' of the Internal Audit Plan'; and
2. Notes the Plant and Fleet Replacement Guideline
3. Notes the Asset Disposal Procedure.

MINGENEW SHIRE COUNCIL ORDINARY MEETING MINUTES – 15 December 2021

10.1.6 That Council receives this report in regard to the material matter raised in the Audit Report for 2020/21 – Operating Surplus Ratio below Department of Local Government, Sport and Cultural Industries' standard for the past three years.

10.1.7 That Council receives the updated Shire of Mingenew Risk Register (reviewed November 2021), as attached.

VOTING REQUIREMENTS:

CARRIED BY SIMPLE MAJORITY 6/0



Auditor General

INDEPENDENT AUDITOR'S REPORT

2021

Shire of Mingenew

To the Councillors of the Shire of Mingenew

Report on the audit of the annual financial report

Opinion

I have audited the financial report of the Shire of Mingenew (Shire) which comprises:

- the Statement of Financial Position at 30 June 2021, 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
- Notes comprising a summary of significant accounting policies and other explanatory information
- the Statement by the Chief Executive Officer.

In my opinion the financial report of the Shire of Mingenew:

- is based on proper accounts and records
- fairly represents, in all material respects, the results of the operations of the Shire for the year ended 30 June 2021 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 section below. I am independent of the Shire in accordance with the *Auditor General Act 2006* and the relevant ethical requirements of the Accounting Professional & Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* (the Code) that are relevant to my audit of the 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 Note 28 to the financial statements which states that the amounts reported in the previously issued 30 June 2020 financial report have been restated and disclosed as comparatives in this financial report. My opinion is not modified in respect of this matter.

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 financial report in accordance with the requirements of the Act, the Regulations and Australian Accounting Standards. The CEO is also responsible for managing internal control (as required by the CEO) to ensure the financial report is free from material misstatement, whether due to fraud or error.

In preparing the 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

As required by the *Auditor General Act 2006*, my responsibility is to express an opinion on the financial report. The objectives of my audit are to obtain reasonable assurance about whether the 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 financial report. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal control.

A further description of my responsibilities for the audit of the financial report is located on the Auditing and Assurance Standards Board website. This description forms part of my auditor's report and can be found at https://www.auasb.gov.au/auditors_responsibilities/ar4.pdf.

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 matter indicates a significant adverse trend in the financial position of the Shire:
 - a) The Operating Surplus Ratio as reported in Note 31 of the annual financial report has been below the Department of Local Government, Sport and Cultural Industries' standard for the last three financial years.
- (ii) The following material matter indicating non-compliance with Part 6 of the Act, the Regulations or applicable financial controls of any other relevant written law was identified during the course of my audit:
 - a) There were inadequate controls to determine if depreciation was being correctly calculated and recorded for certain infrastructure assets. This increased the risk of expenses being understated and assets being overstated.
- (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 financial report were supported by verifiable information and reasonable assumptions.

Other information

The other information is the information in the entity's annual report for the year ended 30 June 2021, but not the financial report and my auditor's report. The CEO is responsible for the preparation and the Council for overseeing the other information.

My opinion does not cover the other information and, accordingly, I do not express any form of assurance conclusion thereon.

Matters relating to the electronic publication of the audited financial report

This auditor's report relates to the financial report of the Shire of Mingenew for the year ended 30 June 2021 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 financial report described above. It does not provide an opinion on any other information which may have been hyperlinked to/from this financial report. If users of the 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 financial report to confirm the information contained in this website version of the financial report.



Steven Hoar
Acting Senior Director Financial Audit
Delegate of the Auditor General for Western Australia
Perth, Western Australia
10 December 2021