



Shire of Irwin

Section 7.12A(4)(a) of the *Local Government Act 1995*
Office of the Auditor General (OAG)
Performance Audit 2019/20

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1 Purpose of Report

The Shire of Irwin's audit for the year ended 30 June 2020 was completed by Moore Australia on behalf of the Office of the Auditor General (OAG) and identified matters that are significant. The purpose of this report is to comply with Section 7.12A(4) (5) of the *Local Government Act 1995* which states 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.*

(5) 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.

The Shire is required to prepare a report for its Audit Committee and seek Council's endorsement before forwarding a copy to the Department.

2 Significant Matter Identified by OAG

Moore Australia on behalf of the Office of the Auditor General (OAG) reported on legal and regulatory requirements in accordance with the Local Government (Audit) Regulations 1996 and identified the following significant matters:

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

- a. The Current Ratio as reported in Note 34 of the annual financial report has been below the Department of Local Government, Sport and Cultural Industries' standard for the past three financial years.*
- b. The Asset Sustainability Ratio as reported in Note 34 of the annual financial report has been below the Department of Local Government, Sport and Cultural Industries' standard for the past three financial years.*
- c. The Operating Surplus Ratio as reported in Note 34 of the annual financial report has been below the Department of Local Government, Sport and Cultural Industries' standard for the past three financial years."*

3 Implication

The possible implications of the significant adverse trends in the financial position of the Shire:

- i) The Current Ratio below the Department of Local Government, Sport and Cultural Industries (DLGSCI) standard for the past three years;
 - Inadequate availability of cash
 - ii) The Asset Sustainability Ratio below the Department of Local Government, Sport and Cultural Industries (DLGSCI) standard for the past three years;
 - Further deterioration of Shire infrastructure and assets
 - Limited opportunity to support community or infrastructure improvement projects
 - iii) The Operating Surplus Ratio below the Department standard for the last three years;
 - The Shire's operating result (ignoring non-operating grants, subsidies and contributions)
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for the year ended 30 June 2020 recorded a net deficit of \$3,478,007 (2019: \$3,734,439). Whilst there was a slight improvement in the net deficit, the long term implication is that there is insufficient funding to maintain the Shire's infrastructure.

4 Management Comment

4.1 Current Ratio

Following the corrective measures taken during the 2018-19 financial year to reduce staff costs as reported to the Minister, the Staff Liabilities Reserve was used to assist with the redundancies, which in turn has impacted the Current Ratio. The Shire has looked at ways to improve the current ratio and has budgeted for a surplus of \$119,050 in the 2020/21 year and is keeping tight controls on expenditure, while investigating ways to increase revenue.

4.2 Operating Surplus Ratio

The Net Result deficit as reported in the Annual Report - Statement of Comprehensive Income of \$1,698,628 in 2018-19 marginally increased to a deficit in 2019-20 to \$1,902,885 when the non-operating grants, subsidies and contributions were included.

The key areas to improve the Operating Surplus Ratio include:

- Increase rate revenue
- Increase operating grants
- Reduce employee costs
- Reduce materials and contract expenditure
- Depreciation cost management

4.2.1 Rate revenue increase

Rate revenue increase could be raised either:

- Directly – raise rates
- Indirectly – long-term growth of the ratepayer base through population growth

A significant rate increase, which is estimated to be well over 50%, would be required to achieve an on-target Operating Surplus Ratio, which is not feasible even if executed over a long period of time.

The long-term growth of the ratepayer base is probable given the large number of resource projects in development together with the attractiveness of Dongara-Port Denison as a tourist destination, but largely controlled by factors outside of the Shire's control.

4.2.2 Operating grants increase

The Shire is on a minimum Federal Assistance Grant and comparatively, receives one of the lowest amounts in regional Western Australia. This has the single most dominant impact on the Shire's financial position.

Generally, operating grant revenue will have matched materials and contracts expenditure, so there is little benefit of pursuing funding opportunities except where the balance of the grant can be used in real terms to offset administration costs such as employee costs. An example would be rural road resheeting, but Main Roads WA (MRWA) Regional Road funding is the only real opportunity for this type of funding support outside of Roads to Recovery and the Federal Assistance Grant. However, MRWA Regional Road funding for rural road resheeting activities is not normally successful due to high competition for the regional pool of funds.

4.2.3 Employee cost reduction

The Shire conducted an organisational review November 2018 resulting in a number of redundancies. Whilst achieving the desired reduction in operating expenditure, its influence on the Operating Surplus Ratio has been minimal plus the Shire is now operating at the bare minimum employee base to meet its core service delivery commitments.

4.2.4 Materials & contracts cost reduction

The Shire is currently operating at the minimum materials and contracts expenditure necessary to meet its core service delivery commitments. The 2019-20 Budget delivered a further reduction in materials and contracts expenditure from a value of \$3,411,187 in 2018-19 to \$3,251,820.

4.2.5 Depreciation

An independent valuation undertaken in 2016 of the Shire's road infrastructure significantly impacted the non-current asset depreciation data from \$2,251,478 in 2016-17 to \$4,152,634 in 2017-18. The Shire has reviewed the external valuation results thoroughly and confident that it is transparent and accurate, but it resulted in a further \$2M deficit of the Net Operating result and a significant decline in the Operating Surplus Ratio.

4.3 Asset Sustainability Ratio

The Shire is focused on using asset management principles to ensure the preservation and integrity for the majority of its infrastructure at a minimum cost when compared to non-current asset depreciation value.

In summary, smaller regional Shire's face similar dilemmas to Irwin by not having a sufficient ratepayer base as well as falling outside of the criteria for the appropriate operating grants whilst having significant infrastructure to maintain.

5 Action Taken

The Shire was able to secure an additional \$687,334 Regional Road Group revenue in the 2020-21 program for the rural road resheeting program plus a \$159,367 reduction in materials and contracts expenditure.

6 Action Intended to be Taken

The Shire is keeping tight controls on expenditure, while investigating ways to increase revenue. The Shire is currently reviewing its Strategic Community Plan which will accurately inform the update of the Corporate Business Plan (CBP) and Long Term Financial Plan (LTFP). The updated CBP and LTFP are anticipated to show the recovery of the Current Ratio, Operating Surplus Ratio and Asset Sustainability Ratio over a 5 year period.

Other immediate actions to be taken include:

- Current Ratio - transfer of some funds back into the Staff Liabilities Reserve given the redundancy work is complete and the Shire finances have stabilised.
 - Operating Surplus Ratio - the Shire will continue to lobby the Grants Commission for a fairer share of the Federal Assistance Grant given the detrimental impact the reduced funding is having on the Shire's financial position.
 - Asset Sustainability Ratio - continue developing its asset management system.
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7 Completion Date

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| • Updated Corporate Business Plan | June 2022 |
| • Updated Long Term Financial Plan | June 2022 |
| • Further Development of the asset management system | Ongoing |

8 Recommendation

In addition to keeping tight controls on expenditure, while investigating ways to increase revenue, it is recommended to:

- Update the Corporate Business Plan
 - Update the Long Term Financial Plan
 - Transfer some funds back into the Staff Liabilities Reserve
 - Continue lobbying the Grants Commission for a fairer share of the Federal Assistance Grant
 - Continue the development of the asset management system
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