



SHIRE OF IRWIN
DONGARA-PORT DENISON

A BRILLIANT BLEND

Shire of Irwin

Section 7.12A(4)(a) of the *Local Government Act 1995*
Office of the Auditor General (OAG)
Performance Audit 2018/19

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1 Purpose of Report

The Shire of Irwin's audit for the year ended 30 June 2019 was completed by Moore Stephens 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 Stephens 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 has been below the Department of Local Government, Sport and Cultural Industries (DLGSCI) standard for the past 2 years.*
- b. The Operating Surplus Ratio has been below the DLGSCI standard for the past 3 years."*

3 Implication

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

- i) Current Ratio below the Department of Local Government, Sport and Cultural Industries (DLGSCI) standard for the past two years;
 - \$80,000 less funds available in the Staff Liabilities Reserve
 - ii) Operating Surplus Ratio below the Department standard for the last three years;
 - As stated in the 2017-18 Management Report prepared by Moore Stephens, there is a significant structural deficit in the Shire operations. The Shire's operating result (ignoring non-operating grants, subsidies and contributions) for the year ended 30 June 2019 recorded a net deficit of \$3,734,439 (2018: \$3,518,679). Whilst there are no short to medium term implications resulting from the structural deficit, the long term implication could be that there is insufficient funding to maintain the Shire's infrastructure.
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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.

4.2 Operating Surplus Ratio

The Net Cash provided by operating activities as reported in the Annual Report - Statement of Cash Flows substantially improved from \$274,657 in 2017-18 to \$1,115,536 in 2018-19. The Net Result as reported in the Annual Report - Statement of Comprehensive Income improved from a deficit of \$2,028,287 in 2017-18 to a deficit of \$1,698,628 in 2018-19 when the non-operating grants, subsidies and contributions were included. However, both of these improved results have not improved the Operating Surplus Ratio.

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 significant reduction in materials and contracts expenditure.

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.

Whilst not being able to significantly impact the depreciation value itself, the Shire is focused on using advanced 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. The advanced asset management principles effectively extend the Remaining Useful Life of the Shire's infrastructure and there is an opportunity to recalculate in the future the non-current asset depreciation value based on this information.

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's submission for MRWA Regional Road funding for rural road resheeting was initially declined, but an additional allocation was made available to the regional fund in November 2019, allowing the previously declined projects to be endorsed. The value of the additional funding was \$602,777.

As stated, the 2019-20 Budget delivered a significant reduction in materials and contracts expenditure. Based on this change alone, the 2019-20 Budget demonstrates a significant improvement in the Operating Surplus Ratio from -53% to -35%.

6 Action Intended to be Taken

6.1 Current Ratio

Transfer of some funds back into the Staff Liabilities Reserve given the redundancy work is complete and the Shire finances have stabilised.

6.2 Operating Surplus Ratio

The Shire will explore opportunities in 2020 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.

The Shire will continue to deploy advanced asset management principles to effectively extend the

Remaining Useful Life of the Shire's infrastructure with the view of recalculating the non-current asset depreciation value.

7 Completion Date

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|--|----------------|
| • Transfer of funds to the Staff Liabilities Reserve | 2020-21 Budget |
| • Lobby the Grants Commission | December 2020 |
| • Corporate Business Plan | December 2020 |
| • Review of the Remaining Useful Life | Ongoing |

8 Recommendation

To ensure the financial recovery and sustainability of the organisation, it is recommended to:

- Review the Long Term Financial Plan 2018-2028 as part of the 2019/20 Budget Review to ensure it is accurately reflecting any organisational or funding changes and the relevant performance metrics are in line with the original projections.
- Update the Corporate Business Plan by December 2020 to demonstrate the alignment of the Long Term Financial Plan 2018-28 and 2019-20 Budget to the 2017-27 Strategic Community Plan.
- Transfer some funds back into the Staff Liabilities Reserve
- Lobby the Grants Commission for a fairer share of the Federal Assistance Grant
- Deploy advanced asset management principles to extend the Remaining Useful Life of the Shire's infrastructure and recalculate the non-current asset depreciation value.

Both the Current Ratio and Operating Surplus Ratio will improve in the next audit period and should not result in a significant adverse trend, though the values will still be below target for the foreseeable future.
