



Shire of
Katanning
Heart of the Great Southern

**MINUTES OF AN
AUDIT AND RISK COMMITTEE MEETING**

Minutes of the Shire of Katanning Audit & Risk Committee
held on Tuesday 30 July 2019 at the
Shire of Katanning Council Chambers.

1. DECLARATION OF OPENING

The meeting was declared open at 5.17 pm.

2. RECORD OF ATTENDANCE

PRESENT

Members: Cr John Goodheart – Deputy President
Cr Owen Boxall
Cr Danny McGrath
Cr Martin Van Koldenhoven
Cr Ernie Menghini

Council Officers: Julian Murphy, Chief Executive Officer
Lisa Hannagan, Executive Manager Finance & Administration
Libby French, Manager Finance

Guests:

Apologies: Cr Liz Guidera -President
Cr Serena Sandwell
Cr Kristy D'Aprile

PRESIDING MEMBER _____

DATE SIGNED _____

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3. DISCLOSURE OF FINANCIAL/IMPARTIALITY INTERESTS**4. CONFIRMATION OF MINUTES OF PREVIOUS MEETING****4.1 Audit and Risk Committee Meeting –Tuesday 25 June 2019****MOVED: CR OWEN BOXALL****SECONDED: CR ERNIE MENGHINI**

(SEE ATTACHED MINUTES)

ARC8/19 That the minutes of the Audit & Risk Committee Meeting held Tuesday 25 June 2019 on be confirmed as a true record of proceedings.**Voting Requirement: Simple Majority**

CARRIED 5/0

5. REPORTS**5.1 2018 Audit Report - Significant Adverse Trends**

File Ref: FM.AU
Reporting Officer: Lisa Hannagan, Executive Manager Finance & Administration
Date Report Prepared: 11 July 2019

Issue:

This report is for Council to consider significant adverse trends in the 30 June 2018 financial position of the Shire of Katanning as presented to the Audit and Risk Committee by Shire Auditor David Tomasi, in December 2018.

While the issue was noted in the agenda item, and the matter was discussed at the meeting, a response has not yet been formalised by Council or forwarded to the DLGSCI, as required by the *Local Government Act 1995*.

Body/Background:

Moore Stephens conducted the Shire of Katanning Annual Audit and the report was presented to the Audit & Risk Committee in December 2018. The Audit Report (and the agenda item) noted two significant trends:

1. Operating Surplus Ratio being below the DLGSCI standard for the past three years;
2. Asset Sustainability Ratio for the current year and previous year being below the DLGSCI standard.

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

Officer's Comment:

The issue of meeting the DLGSCI standard for these two ratios in particular is much greater than for this Council alone.

While this officer accepts that the Shire of Katanning has not met the targets set by the DLGSCI, in a brief review of the MyCouncil website (undertaken with the aim of finding a local government that I could speak to about how they comply with these ratios), I was unable to find any local government who had actually succeeded in meeting either of these targets.

While not exhaustive, my review included Shires of Bridgetown-Greenbushes, Gnowangerup, Esperance, Serpentine-Jarrahdale, Waroona, Corrigin, Toodyay, Donnybrook-Balingup, Collie, Manjimup, Kojonup, Capel, Denmark, Moora, Plantagenet, Narrogin, Williams and City's of Albany and Bunbury.

According to the Shire’s Auditors:

Ratios provide useful information when compared to industry and internal benchmarks and assist in identifying trends. Whilst not conclusive in themselves, understanding ratios, their trends and how they interact is beneficial for the allocation of scarce resources and planning for the future.

In relation to the Operating Surplus Ratio, the ratio represents the percentage by which the operating surplus (or deficit) differs from the Shire’s own source funding, which includes rates.

Operating Surplus Ratio =	<u>Operating Revenue MINUS Operating Expense</u> Own source Operating Revenue
Purpose	The ratio is a measure of a local governments ability to cover operational costs and have revenue available for capital funding or other purposes.

The Shire Auditors noted that in the year ended 30 June 2018, this ratio was distorted by the early receipt of Financial Assistance Grants and one-off revenue and expenditure related to flood damage events in 2016/2017 but also noted that the Shire would not have met the ratio even if the two issues noted had not occurred.

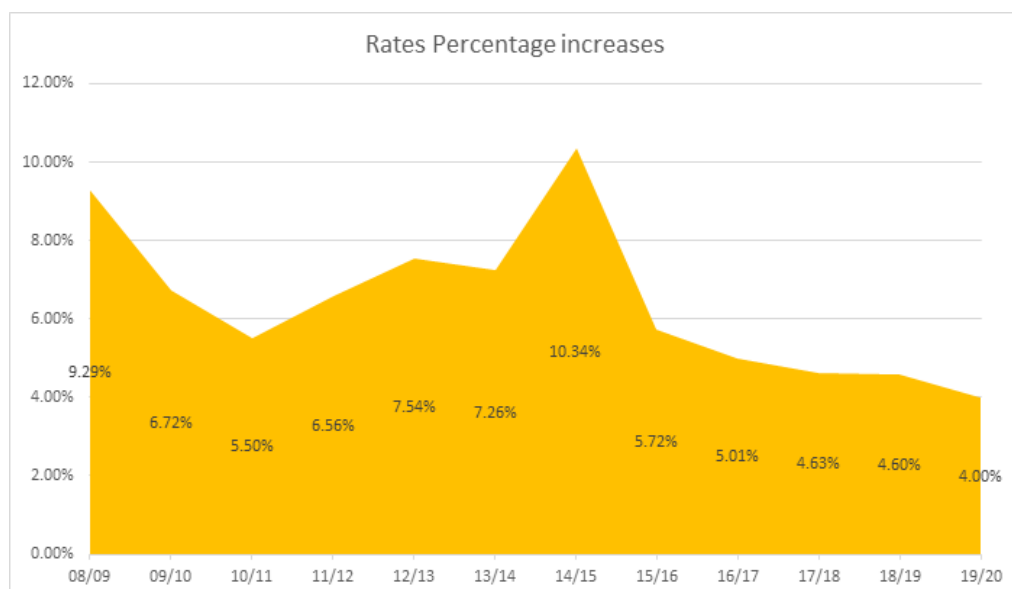
To improve this ratio, Council would need to:

1. Increase Own Source Revenue (rates, fees & charges, reimbursements, interest and profit on disposal of assets);
2. Decrease Operating Expense.

Council are quite constrained in respect to both increasing revenue and decreasing expenses.

Increasing rates, fees and charges, at too high a rate is problematic, but setting them too low is also contributing negatively on long term sustainability of the Shire.

Over recent years, Council continue to reduce the rates levied, as demonstrated by this graph:



NB. * 2019/20 suggested rate of 4% is recommended, but as 2019/20 budget has not been finalised, can only be considered indicative at this point.

To improve the Operating Surplus Ratio, Council need to maintain consistent rate and fees/charges increases at between 4-5% per annum. Rate increases are particularly important as they compound each year, providing a larger base for the following year.

In relation to decreasing operating expenditure, several costs such as utilities, interest and insurance are difficult to reduce. Employee costs, which are significant, are more fluid and reduction of costs in this area would have a positive effect on this ratio.

An operational review has commenced (June 2019) that seeks to streamline activity and increase efficiency across the organisation. The result of this review will likely result in a significant reduction in employee costs, and this will see an improvement in this ratio.

Asset Sustainability Ratio

Moore Stephen's Audit commentary in January 2018 noted that "interpretation of this ratio should also be considered with the Asset Consumption Ratio and the Asset Renewal Funding Ratio".

Both of these ratios are currently meeting and exceeding the DLGSCI targets.

In relation to the Asset Sustainability Ratio, the ratio expresses capital expenditure on renewal and replacement of existing assets as a percentage of depreciation costs. The ratio is used to identify any potential decline or improvement in asset conditions. A percentage of less than 100% on an ongoing basis indicates assets may be deteriorating at a greater rate than spending on renewal or replacement.

Asset Sustainability Ratio =	$\frac{\text{Capital Renewal and Replacement Expenditure}}{\text{Depreciation}}$
Purpose	The ratio indicates whether a local government is replacing or renewing existing non-financial assets at the same rate that its overall asset stock is wearing out.

The issue for the Shire of Katanning (and in fact all Western Australian local governments) is that, due to the requirement for local governments to move to the fair value method of valuation, the Shire's depreciation costs have exponentially increased over the past five years.

As each asset class was revalued to fair value, the result on depreciation costs has seen an increase, since 2012/13 financial year, of **333%**.

Financial Year	Depreciation Cost
2012/13	1,030,783
2013/14	1,553,446
2014/15	2,082,746
2015/16	3,179,636

2016/17	3,264,209
2017/18	4,466,902

The Shire's entire non-financial asset inventory is now valued at fair value.

In this officer's opinion the adverse trend will therefore not continue to increase dramatically, but it is very difficult to see what Council could do to meet the current standard set by the DLGSCI.

A substantial reduction in the Shire's assets could reduce annual depreciation costs. Unfortunately, the most significant depreciation costs are associated with Shire roads (\$1.27m, 17/18) and buildings (\$1.80m, 17/18). The Shire is not able to sell its roads.

Council considered the Shire's built assets at an Asset Management Workshop held in March 2019 and that review identified only a limited stock of buildings that could be sold.

An operational review has commenced (June 2019) that is seeking to streamline and increase efficiency across the organisation.

It is expected the review may result in a reduction of depreciable assets across plant and equipment, motor vehicles and residential properties and that may bring minor improvements to this ratio.

Unless there is a change in the status quo eg. a change in the DLGSCI's operating surplus ratio standard of zero; or a transfer of the Shire's circa \$122m of roads back to the State, this Council will necessarily be reporting non-compliance to this ratio going forward.

Statutory Environment:

Local Government (Audit) Regulations 1996

Policy Implications:

Nil.

Financial Implications:

Nil.

Risk Implications:

This item has been evaluated against the Shire of Katanning's Risk Assessment and Acceptance Criteria. The perceived level of risk is considered to be "Low" risk and can be managed by routine procedures and with current resources.

Strategic Implications:

Shire of Katanning Strategic Community Plan 2017 – 2027

PRIORITY	LEADERSHIP	
ASPIRATION	L2	A collaborative, progressive and resilient local government which is sustainably resourced.
OBJECTIVE	L2.1	Optimise use of shire resources – improve organisational systems.

Officer's Recommendation/Council Motion:**MOVED: CR MARTIN VAN KOLDENHOVEN****SECONDED: CR OWEN BOXALL****ARC9/19 That the Audit Committee:**

- 1. Recognises and reports to Council that, relative to the Department of Local Government, Sport and Cultural Industries criteria, the Shire is not meeting the standard for the operating surplus ratio or asset sustainability ratio;**
- 2. Directs the CEO to advise the Minister in writing that:**
 - a. Council are focused on the long-term sustainability of the Shire and are cognisant of the requirement to ensure own source revenues, including rates and fees and charges are increased at appropriate levels and that expenditure is closely monitored and managed;**
 - b. In relation to the Operating Surplus Ratio, the Shire of Katanning has commenced a major review into the organisational operations and structure that will result in a significant reduction in operating expenses. The review will conclude, and changes be implemented during the 2019/20 financial year; and**
 - c. In relation to the Asset Sustainability Ratio, the Shire of Katanning will continue to develop its Asset Management Strategy and Plans with a renewed focus on reducing any non-essential properties on the Shire Register. The review of the organisational operations and structure may also contribute to a reduction in other assets such as plant, equipment and motor vehicles.**

Voting Requirement: Simple Majority

CARRIED 5/0

Cr Martin van Koldenhoven spoke for the motion.

Cr John Goodheart spoke for the motion.

6. CLOSURE OF MEETING

The Presiding Member declared the meeting closed at 5.25pm.