# ACTION REPORT – 2019 - 2020 Significant Adverse Trend – Asset Sustainability Ratio and Operating Surplus Ratio

Section 7.12A (4) of the *Local Government Act 1995* requires a local government to prepare a report stating what action has been taken or is intended to be taken in respect to matters raised within the audit report. The Shire of Leonora’s 2019-2020 Audit Report from Butler Settineri (Audit) Pty Ltd noted a significant adverse trend for the asset sustainability and operating surplus ratios. This was also the first year that the audit process had been overseen by the Office of the Auditor General who reported that:

*In accordance with the Local Government (Audit) Regulations 1996 I report that:*

*(i) In my opinion, the following material matters indicate significant adverse trends in the financial position of the shire:*

 *a. The Asset Sustainability Ratio as reported in Note 29 of the annual financial*

 *report is below the Department of Local Government, Sport and Cultural*

 *Industries’ basic standard for the past two years and the current year is*

 *below last year, and*

 *b. The Operating Surplus Ratio as reported in Note 29 of the annual financial*

 *report is below the Department of Local Government, Sport and Cultural*

 *Industries’ basic standard for the past three financial years.*

# Shire of Leonora – Asset Sustainability Ratio

Asset Sustainability Ratio capital renewal and replacement expenditure

 depreciation

The Asset Sustainability Ratio demonstrates the extent to which the Shire of Leonora is replacing or renewing existing assets at the same rate that its overall asset stock is wearing out. A basic standard is met if the ratio is greater than 0.9 and advanced standard is if the ratio is above 1.1. The Shire’s Asset Sustainability Ratio was at an advanced standard at the end of the 2017/18 financial year, but it is the trend lower that is of concern. The ratio over the past three years is listed below:

|  |  |  |
| --- | --- | --- |
| **2018** | **2019** | **2020** |
| 1.84 | 0.76 | 0.56 |

# Explanation for Asset Sustainability Ratio Not Meeting Benchmarks

# The Asset Sustainability Ratio can be affected by the revaluation of assets and the subsequent increase and decrease in depreciation. Our road network will be revalued in the 2021/22 Financial Year and the Shire will closely monitor any changes to the depreciation to ensure they are not overstated.

# In the 2019/20 Financial Year there was the effect of the COVID-19 pandemic and the inability to engage contractors to complete new or renewal infrastructure projects, as well as the difficulties in purchasing capital items. The poor seasonal year also impacted on reducing both the maintenance and capital budget expenditure within the road network budget as no rain limited grading (maintenance) and construction (renewal) projects.

It is intended for future renewal works to be undertaken in accordance with our Integrated Planning and Reporting Plans.

# Act**ions Proposed to Address the Asset Sustainability Ratio**

# Increased scrutiny of the revaluation of infrastructure and its affect on depreciation, and greater alignment with the Long Term Financial Plan and the implementation of any programs to ensure that all renewal projects are captured as such, and not under the maintenance budget. Within the financial resources of the Shire of Leonora, focus attention on grant funding for renewal projects and increase expenditure through accessing funds set aside in Reserves.

# Shire of Leonora – Operating Surplus Ratio

Operating Surplus Ratio Operating Revenue MINUS Operating Expenditure

 Own Source Operating Revenue

#

The operating surplus ratio demonstrates the extent to which operating revenues cover operating expenses (including depreciation), with a positive operating surplus ratio considered by the Department an indicator of long-term financial sustainability. The Shire’s operating surplus ratio has experienced movement over the previous three years as below but is following a positive trend upwards:

|  |  |  |
| --- | --- | --- |
| **2018** | **2019** | **2020** |
| (0.11) | (0.04) | (0.01) |

The basic benchmark set by the Department of Local Government, Sport and Cultural Industries (the Department) for the operating surplus ratio is 0.01 – 0.15. Ratios higher than 0.15 are in the desirable benchmark range set by the Department.

# Explanation for Operating Surplus Ratio Not Meeting Benchmarks

Several factors contribute to the fluctuation of this ratio. As the processes to receive funds are onerous with significant periods of time being required to receive approval, the operating surplus ratio can be somewhat manipulated given the timing of revenue and expenses and the recognition of revenue under the new AASB standards.

The Shire has also considered within its Long Term Financial Plan (LTFP) the impact of ongoing capital road funds such as Roads to Recovery (R2R) and Regional Road Group (RRG) – neither of which are included in the calculation of the operating surplus ratio. Depreciation expense, which is included within the calculation of the operating surplus ratio, is rarely funded in full by rural local governments such as the Shire of Leonora, with grant funds such as the R2R and RRG contributing to asset renewals and compensating for operating losses. Depreciation will be closely monitored in the 2021/2022 financial year.

# Act**ions Proposed to Address the Operating Surplus Ratio**

To ensure the operating surplus ratio would meet the benchmark set by the Department, the Shire could consider increasing rates, however this would effectively result in over rating the community when also considering the ongoing road grants received by the Shire. As a result, the Shire considers the benchmark for the operating surplus ratio to be flawed for a Shire receiving non-operating grants for the renewal of assets, and it does not intend to take action to increase revenue above a level which will result in the community being overrated when considering expected and ongoing non-operating grants for asset renewals.

The operating surplus ratio and the financial performance of the Shire of Leonora will continue to be reviewed through ongoing monitoring of depreciation expense and financial reports which are reported to Council, including required budget reviews and monthly statements of financial activity. Close attention will be paid to revaluations that may have a negative impact on the ratio in the 2021/22 Financial Year.

The Council will continue to expand its operations in order to find other alternative revenue sources in line with the Shire of Leonora’s Strategic Community Plan 2017 – 2027.

# Disclaimer

This Report has been prepared for the exclusive use by the Shire of Leonora.

This report contains quantitative and qualitative statements, including projections, estimates, opinions and forecasts concerning the anticipated future performance of the Shire of Leonora, based on a large number of assumptions, and will be, subject to significant uncertainties and contingencies many, if not all, of which are outside the control of the Shire of Leonora.

This report is supplied in good faith for public information purposes and the Shire accepts no responsibility for any loss occasioned by any person acting or refraining from action as a result of reliance on this Report.

# Document Management

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