



## **ACTION REPORT – 2020 - 2021 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 Independent Auditor's Report for 2020-21 issued by the Office of the Auditor General (OAG), noted a significant adverse trend for the asset sustainability and operating surplus ratio.

### **Shire of Leonora – Asset Sustainability Ratio**

Asset Sustainability Ratio  $\frac{\text{capital renewal and replacement expenditure}}{\text{depreciation}}$

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 depreciating. 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 ratio over the past three years is listed below:

<b>2019</b>	<b>2020</b>	<b>2021</b>
0.76	0.56	0.59

### **Explanation for Asset Sustainability Ratio Not Meeting Benchmarks**

The Asset Sustainability Ratio can be influenced by a number of factors such as revaluation of assets and the subsequent increase and decrease in depreciation expense, as well as the amount being expended on renewal and replacement of assets annually. When considering the calculation of this ratio, the expected requirement to expend the equivalent of depreciation expense annually through the renewal and replacement of assets may not be reasonable.

Fluctuations will generally be observed with asset renewals annually. When required renewals are examined within the long term financial and asset management plans, it will reflect renewal and replacement requirements in some years are higher, as assets come to the end of their useful life. In other years, where assets are not required to be replaced or renewed, fluctuations or spikes in the level of renewal and replacement requirements will likely be observed at a much lower level than where assets have reached the end of their useful life. Due to these fluctuations described, the expenditure for asset renewal and replacement may not be equivalent to depreciation expenditure in each year when following integrated planning and reporting plans and undertaking sound asset management practices.

## Actions Proposed to Address the Asset Sustainability Ratio

The Shire of Leonora intends for future renewal and replacement of assets to be undertaken in accordance with integrated planning and reporting plans. These plans reflect asset replacement and renewal requirements against depreciation expenditure over the term of the plan (fifteen years), as well as annually, to allow for better consideration and measurement of whether assets are being renewed at the same rate they are depreciating.

## Shire of Leonora – Operating Surplus Ratio

Operating Surplus Ratio  $\frac{\text{Operating Revenue MINUS Operating Expenditure}}{\text{Own Source Operating Revenue}}$

The operating surplus ratio demonstrates the extent to which operating revenues cover operating expenses (including depreciation expense), 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:

2019	2020	2021
(0.05)	(0.01)	(0.05)

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. The Shire of Leonora has experienced a downward trend with its operating surplus ratio in 2020/21 which does not meet the benchmark set by the Department, resulting in the 'significant adverse trend' finding on the Shire's audit report.

## Explanation for Operating Surplus Ratio Not Meeting Benchmarks

The Shire has 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 arising from depreciation expense.

## Actions 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.

## **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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