



Audit Findings for the
Financial Year Ended 30th June 2018

Report on Significant Matter

Operating Surplus Ratio Tend

21 August 2019



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Background

The Shire of Donnybrook Balingup is required to prepare an audited Annual Financial Report each financial year under the Local Government Act 1995 (the Act).

Council's auditor is AMD Chartered Accountants (AMD), are contracted for audit services with the Council and are an accredited agent of the Office of the Auditor General (OAG). AMD's 30 June 2018 audit report of the Shire of Donnybrook Balingup is attached at appendix 1 of this document.

A key audit requirement is the responsibility for the auditor to identify any financial trends which it considers adverse and of concern.

Regulation 50 of the Local Government (Financial Management) Regulations 1996 requires the inclusion of seven ratios in the Annual Financial Report.

50. Financial ratios to be included in annual financial report

- (1) *The annual financial report is to include, for the financial year covered by the annual financial report and the 2 preceding financial years —*
 - (a) *the current ratio; and*
 - (b) *the asset consumption ratio; and*
 - (c) *the asset renewal funding ratio; and*
 - (d) *the asset sustainability ratio; and*
 - (e) *the debt service cover ratio; and*
 - (f) *the operating surplus ratio; and*
 - (g) *the own source revenue coverage ratio.*

For the financial year ended 30 June 2018, AMD has reported a significant adverse trend in the Operating Surplus Ratio. The Department of Local Government, Sport and Cultural Industries, has noted that this measure has not met the basic standard for the last 3 years (appendix 2);

In our opinion, the following matter indicate a significant adverse trend in the financial position of the Shire of Donnybrook-Balingup:

- a. *Operating surplus ratio as reported in Note 19 of the financial report is below the Department of Local Government, Sport and Cultural Industries (DLGSCI) standard of zero for the last three years (2016: -0.57, 2017: -0.39 and 2018: -0.49).*



Operating Surplus Ratio

As per **Local Government Operational Guidelines No18 – Financial Ratios** published by the Department in 2015, The Operating Surplus Ratio measure is described as follows.

A key indicator of a local government's financial performance is measured by the 'Operating Surplus Ratio'. If a local government consistently achieves a positive operating surplus ratio and has soundly based long term financial plans showing that it can continue to do so in future, having regard to asset management and the community's service level needs, then it is considered financially sustainable.

A positive ratio indicates the percentage of total own source revenue available to help fund proposed capital expenditure, transfer to cash reserves or to reduce debt. A negative ratio indicates the percentage increase in total own source revenue (principally rates) that would have been required to achieve a break-even operating result.

Statutory financial ratio results for the Shire of Donnybrook Balingup against Department of Local Government, Sport and Cultural Industries benchmarks

	Standard	2017/18	2016/17	2015/16	2014/15	2013/14	5 Year Average
Current Ratio	1.00	✓ 1.96	✓ 2.65	✗ 0.71	✓ 1.35	✗ 0.77	✓ 1.49
Asset Consumption Ratio	0.50	✓ 0.65	✓ 0.65	✓ 0.59	✓ 0.69	✓ 0.64	✓ 0.64
Asset Renewal Ratio	0.75	✓ 0.87	✓ 1.15	✗ 0.31	✗ 0.61	✗ 0.42	✗ 0.67
Asset Sustainability Ratio	0.90	✗ 0.55	✗ 0.54	✓ 0.93	✗ 0.62	✗ 0.60	✗ 0.65
Debt Service Cover Ratio	2.00	✓ 15.81	✓ 4.01	✓ 2.47	✓ 14.17	✓ 2.68	✓ 7.83
Operating Surplus Ratio	0.01	✗ (0.49)	✗ (0.38)	✗ (0.57)	✗ (0.23)	✗ (0.38)	✗ (0.41)
Own Source Revenue Coverage Ratio	0.40	✓ 0.49	✓ 0.48	✓ 0.52	✓ 0.54	✓ 0.58	✓ 0.52
	Standard	2017/18	2016/17	2015/16	2014/15	2013/14	5 Year Average
Financial Health Indicator (max = 100)	70.00	✗ 65.00	✗ 64.00	✗ 36.00	✗ 60.00	✗ 33.00	✗ 51.60

source: mycouncil.wa.gov.au

	Standard	2017/18	2016/17	2015/16	2014/15	2013/14	5 Year Average
Operating Surplus Ratio	0.01	✗ (0.49)	✗ (0.38)	✗ (0.57)	✗ (0.23)	✗ (0.38)	✗ (0.41)



The Department of Local Government, Sport and Cultural Industries considers a “basic” standard to be between 1% and 15% and an “advanced” standard with a measure of over 15%.

<i>Operating Surplus Ratio</i>	
<i>Operating Surplus Ratio =</i>	$\frac{(\text{Operating Revenue MINUS Operating Expense})}{\text{Own Source Operating Revenue}}$
<i>Purpose:</i>	<i>This ratio is a measure of a local government’s ability to cover its operational costs and have revenues available for capital funding or other purposes.</i>
<i>Standards:</i>	Basic Standard between 1% and 15% (0.01 and 0.15) Advanced Standard > 15% (>0.15).
<i>Definitions:</i>	
<i>‘Operating Revenue’</i>	<i>Means the revenue that is operating revenue for the purposes of the AAS, excluding grants and contributions for the development or acquisition of assets.</i>
<i>‘Operating Expense’</i>	<i>Means the expense that is operating expense for the purposes of the AAS.</i>
<i>‘Own Source Operating Revenue’</i>	<i>Means revenue from rates and service charges, fees and user charges, reimbursements and recoveries *, interest income and profit on disposal of assets.</i>



s7.12A of the Act requires the following relating to significant matters raised in the audit report

- (4) *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.*

Department of Local Government, Sport and Cultural Industries has advised Local Governments of the requirement in Department Circular 05-2009

LOCAL GOVERNMENT AUDITING

Local governments are reminded of their audit reporting obligations under section 7.12A(4)(a) of the Local Government Act 1995.

To assist, the department has prepared a template for use by local governments.

While the template is not in a prescribed form it is suggested that it is used by local governments to standardise the report format and support a uniform process.

Reporting requirements

In November 2017 the proclamation of the Local Government Amendment (Auditing) Act 2017 introduced a number of reforms to auditing laws.

These were outlined in Circular 16-2017 and the accompanying Guide to Local Government Auditing.

This included the introduction of a new category of audits called Performance Audits.

Legislation also now requires local governments to examine an audit report it receives and implement appropriate action in respect to the significant matters raised.

Local governments must prepare a report addressing the significant matters identified in the audit report.

The report should then be considered by the local government's audit committee before being adopted by council.

This report is to be provided to the Minister within three months of receiving the audit report and within 14 days after the local government gives the report to the Minister, the CEO must publish a copy of the report on the local government's official website.

This requirement applies to both a local government's financial audit as well as any Performance Audits undertaken by the Auditor General.

To date the Auditor General has undertaken a number of Performance Audits of selected local governments that include Records Management, Local Government Procurement, Timely Payment of Suppliers and Controls Over Corporate Credit Cards.



Section 7.12A(4)(a) of the Local Government Act 1995 (the Act) refers to the preparation of a report by a local government.

The report is to address any matters identified as significant by the auditor in the audit report, the report is to also state what action the local government has or intends to take in respect to each of those matters.

The Department proposes to maintain the ongoing process of examining audit reports to ensure compliance and monitoring the actions that local governments take or intend to take in addressing any significant matters identified in the audit reports.

If you have any questions regarding this information, please contact the Department on (08) 6551 8700 or via email audits@dlgsc.wa.gov.au .

The Department of Local Government, Sport and Cultural Industries has advised the reporting to be in the following format

*TEMPLATE
REPORT*

Section 7.12A(4)(a) of the Local Government Act 1995

Office of the Auditor General (OAG) – Performance Audit

Purpose of Report

Significant Matter Identified by OAG

Implication

Management Comment

Action Taken or Intended to be Taken

Completion or Proposed Completion Date

Recommendation



Report per Section 7.12A(4)(a) of the Local Government Act 1995

Council considered a recommendation from the Shire Audit Committee and resolved on the 21 August 2019 the following response in accordance with 7.12A(4)(a) of the Act.

1. Purpose of Report

To respond to the Department of Local Government, Sport and Cultural Industries in compliance of S7.12A of the Local Government Act 1995 relating to significant matter raised in the 2017/18 audit report.

2. Significant Matter Identified by OAG

Report on Other Legal and Regulatory Requirements

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

- (i) In our opinion, the following matter indicate a significant adverse trend in the financial position of the Shire of Donnybrook-Balingup:
 - a. Operating surplus ratio as reported in Note 19 of the financial report is below the Department of Local Government, Sport and Cultural Industries (DLGSCI) standard of zero for the last three years (2016: -0.57, 2017: -0.39 and 2018: -0.49).**

3. Implication

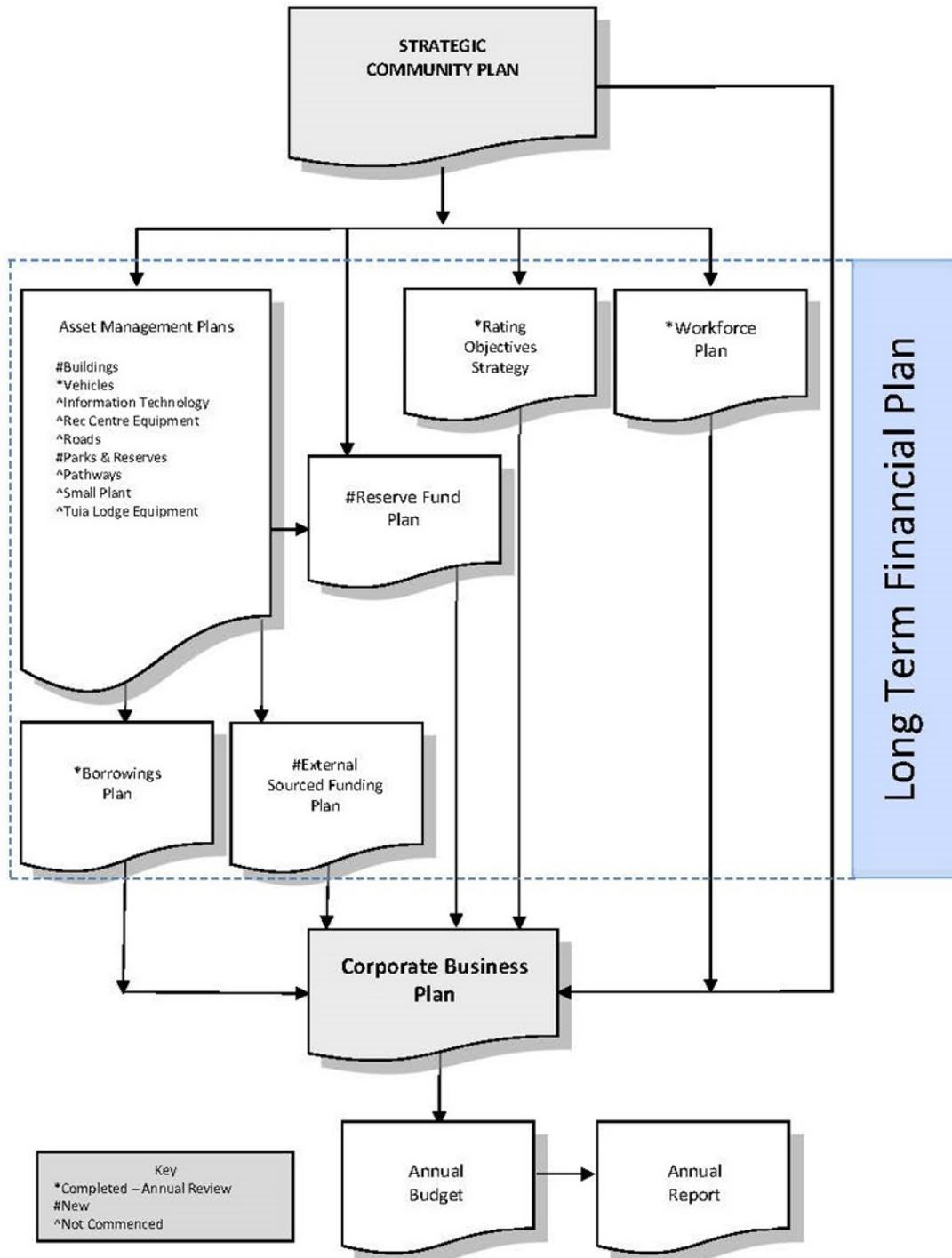
If a Local Government runs ongoing underlying operating deficits, it needs to recognise the longer-term implications. Not addressing ongoing deficits is likely to mean that future Councils will struggle to be able to accommodate asset renewal needs and that service levels will decline over time. It is acknowledged that a trending reduction in the operating deficit is necessary for improved sustainable financial health of the Shire.

4. Management Comment

Historically, the Shire has had no robust integrated financial planning framework that incorporates sustainable 'own source' funded long term asset management plans. It is the opinion of officers that this has resulted in a more adverse financial position of the Shire that would ordinarily be the case under a fully developed Integrated Financial Planning Framework.

The Shire of Donnybrook Balingup is transitioning towards improved long term financial sustainability, an Integrated Financial Planning Framework was developed in 2018 (Table A).

Table A



5. Action Taken or Intended to be Taken

A suite of financial planning systems are being developed and implemented that will;

- a) Accurately demonstrate the Shire's capability to deliver services and manage its asset portfolio that can sustain our community into the future.
- b) Accurately determine the real cost of managing the Shire's asset portfolio.
- c) Accurately determine the real cost of delivering services to the community.
- d) Accurately determine the real contribution residents and users should make to the cost of services & facilities.

Since introducing the Integrated Financial Planning Framework in 2018 the following documents and long term financial plans have been developed and presented to Council.

	Introduced
Workforce Plan	2018
Borrowings Plan	2018
Rating Objectives Strategy	2018
Asset Management Plan – Vehicles	2018
Asset Management Plan – Buildings	2019
Asset Management Plan – Parks & Reserves	2019
Reserves Fund Plan	2019
External Sourced Funding Plan	2019

The following plans have been identified as required and are planned for future development.

Asset Management Plan – Information Technology
Asset Management Plan – Recreation Centre Equipment
Asset Management Plan – Roads
Asset Management Plan – Pathways
Asset Management Plan – Small Plant
Asset Management Plan – Tuia Lodge Equipment

This Integrated Financial Planning Framework and is reliant upon the developed sustainable 'own source' funding model being embedded within the annual budgetary process.

6. Completion or Proposed Completion Date

Council is committed to reduce the Operating Deficit and improving the Operating Surplus Ratio.

Since introducing the Integrated Financial Planning Framework in 2018 the following documents and long term financial plans have been developed and presented to Council.

	Introduced
Workforce Plan	2018
Borrowings Plan	2018
Rating Objectives Strategy	2018
Asset Management Plan – Vehicles	2018
Asset Management Plan – Buildings	2019
Asset Management Plan – Parks & Reserves	2019
Reserves Fund Plan	2019
External Sourced Funding Plan	2019

The following plans have been identified as required and are planned for future development across the next 5 years.

Asset Management Plan – Information Technology
Asset Management Plan – Recreation Centre Equipment
Asset Management Plan – Roads
Asset Management Plan – Pathways
Asset Management Plan – Small Plant
Asset Management Plan – Tuia Lodge Equipment

It is expected that the ongoing development of the Integrated Financial Planning Framework will lead to a trending improvement in the Operating Surplus Ratio and overall financial health of the Shire of Donnybrook Balingup.

7. Recommendation

That Council is committed to a trending improvement in the Operating Surplus Ratio and long term sustainable financial health of the Shire of Donnybrook Balingup through continued implementation and funding of its Integrated Financial Planning Framework.

Appendix 1 – Audit Report 2017/18

INDEPENDENT AUDITOR'S REPORT

To the Council of Shire of Donnybrook-Balingup

Report on the Audit of the Financial Report

Opinion

We have audited the annual financial report of Shire of Donnybrook-Balingup which comprises the Statement of Financial Position as at 30 June 2018, the Statement of Comprehensive Income by Nature or Type, Statement of Comprehensive Income by Program, Statement of Changes in Equity, Statement of Cash Flows and Rate Setting Statement for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information, and the Statement by the Chief Executive Officer.

In our opinion the annual financial report of Shire of Donnybrook-Balingup:

- (i) is based on proper accounts and records; and
- (ii) fairly represents, in all material respects, the results of the operations of Shire of Donnybrook-Balingup for the year ended 30 June 2018 and its financial position at the end of that period in accordance with the *Local Government Act 1995* (the Act) and, to the extent that they are not inconsistent with the Act, Australian Accounting Standards.

Basis for Opinion

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Report* section of our report. We are independent of Shire of Donnybrook-Balingup in accordance with the relevant ethical requirements of the Accounting Professional and Ethical Standards Board's *APES 110 Code of Ethics for Professional Accountants* (the Code) that are relevant to our audit of the financial report. We have also fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter – Basis of Accounting

We draw attention to Note 1 to the financial report, which describes the basis of accounting. The financial report has been prepared for the purpose of fulfilling Shire of Donnybrook-Balingup's financial reporting responsibilities under the Act. Regulation 16 of the Local Government (Financial Management) Regulations 1996 (Regulations), does not allow a local government to recognise some categories of land, including land under roads, as assets in the annual financial report. Our opinion is not modified in respect of this matter.

Responsibilities of the Chief Executive Officer and Council for the Financial Report

The Chief Executive Officer (CEO) of Shire of Donnybrook-Balingup is responsible for the preparation and fair presentation of the annual financial report in accordance with the requirements of the Act, the Regulations and, to the extent that they are not inconsistent with the Act, Australian Accounting Standards. The CEO is also responsible for such internal control as the CEO determines is necessary to enable the preparation of a financial report that is free from material misstatement, whether due to fraud or error.

In preparing the financial report, the CEO is responsible for assessing Shire of Donnybrook-Balingup's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the State government has made decisions affecting the continued existence of Shire of Donnybrook-Balingup.

The Council is responsible for overseeing Shire of Donnybrook-Balingup's financial reporting process.

Auditor's Responsibility for the Audit of the Financial Report

The objectives of our audit are to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial report.

As part of an audit in accordance with Australian Auditing Standards, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Shire of Donnybrook-Balingup's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the CEO.
- Conclude on the appropriateness of the CEO's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on Shire of Donnybrook-Balingup's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial report or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report, as we cannot predict future events or conditions that may have an impact.
- Evaluate the overall presentation, structure and content of the financial report, including the disclosures, and whether the financial report represents the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Council and the CEO regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Report on Other Legal and Regulatory Requirements

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

- (i) In our opinion, the following matter indicate a significant adverse trend in the financial position of the Shire of Donnybrook-Balingup:
 - a. Operating surplus ratio as reported in Note 19 of the financial report is below the Department of Local Government, Sport and Cultural Industries (DLGSCI) standard of zero for the last three years (2016: -0.57, 2017: -0.39 and 2018: -0.49).
- (ii) There were no matters indicating non-compliance with Part 6 of the *Local Government Act 1995*, the *Local Government (Financial Management) Regulations 1996* or applicable financial controls of any other written law identified during the course of our audit, with exception of the following:
 - The annual financial report for 30 June 2018 was not submitted to the auditor by the extension date of 31 October 2018 approved by the Department of Local Government, Sport and Cultural Industries as required by section 6.4 of the *Local Government Act 1995*; and
 - The compliance audit return for the year ended 31 December 2017 was not submitted to the Executive Director at Department of Local Government, Sport and Cultural Industries by 31 March 2018 as required by the *Local Government (Audit) Regulations 1996*.
- (iii) All required information and explanations were obtained by us.
- (iv) All audit procedures were satisfactorily completed.
- (v) In our opinion, the asset consumption ratio and the asset renewal ratio included in the annual financial report were supported by verifiable information and reasonable assumptions.

Matters Relating to the Electronic Publication of the Audited Financial Report

This auditor's report relates to the annual financial report of Shire of Donnybrook-Balingup for the year ended 30 June 2018 included on Shire of Donnybrook-Balingup's website. Shire of Donnybrook-Balingup's management is responsible for the integrity of Shire of Donnybrook-Balingup website. This audit does not provide assurance on the integrity of Shire of Donnybrook-Balingup's website. The auditor's report refers only to the financial report described above. It does not provide an opinion on any other information which may have been hyperlinked to/from this financial report. If users of the financial report are concerned with the inherent risks arising from publication on a website, they are advised to refer to the hard copy of the audited financial report to confirm the information contained in this website version of the financial report.

AMD Chartered Accountants



TIM PARTRIDGE
Director

28-30 Wellington Street, Bunbury, Western Australia

Dated this 17th day of December 2018



Appendix 2 – Correspondence from the Department of Local Government, Sport and Cultural Industries



Department of
Local Government, Sport
and Cultural Industries

Our ref DB3-4#03 E1915560
Enquiries Stuart Fraser
Phone 65521586
Email stuart.fraser@dlgsc.wa.gov.au

Mr Ben Rose
Chief Executive Officer
Shire of Donnybrook Balingup
PO Box 94
DONNYBROOK WA 6239

SHIRE OF DONNYBROOK BALINGUP
RECEIVED
- 4 JUL 2019
Record No: KOR 70043
File No: FNC02
Officer: BAR
X Ref:
Correspond:
Signed Off:

Dear Mr Rose

The Department of Local Government, Sport and Cultural Industries (the Department) has received the Shire's 2017-18 Audit Report from AMD Chartered Accountants dated 17 December 2018.

The Audit Report identifies matters as significant in regard to adverse trends, qualified audits and other matters. The following matter is identified as significant by the auditor:

- Significant adverse trend in the financial position of the Shire: Operating Surplus Ratio below the Department standard for the last three years.

Section 7.12A(4) of the *Local Government Act 1995* states that a local government must:

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.

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.

To date it appears that a report has not been received and has not been published on the Shire's official website in accordance with Section 7.12A.

As a matter of priority the Shire must prepare a report for its Audit Committee and seek council's endorsement before forwarding a copy to the Department at audits@dlgsc.wa.gov.au

As this report is now overdue, the Department requires the local government to remedy this non-compliance within the next 60 days from the date of this letter.

For further information please review the Department's Circulars 05-2019 Local Government Auditing and 02-2018 Guide to Local Government Auditing Reforms (page 8) which are published on the Department's website.

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