



Minister of Local Government
Via Mr Duncan Ord
Director General
Department of Local Government, Sport and Cultural Industries
GPO Box 8349
Perth Business Centre WA 6849

Dear Mr Ord,

RE: SIGNIFICANT AUDIT MATTERS AS PER SECTION 7.12A(4) OF THE LOCAL GOVERNMENT ACT 1995

Please find enclosed, pursuant to section 7.12A(4) of the Local Government Act 1995, an excerpt of the minutes, including the audit report for 2017/18, from the Shire's Audit Committee meeting on 27 March 2019. The Act requires that a copy of the Shire's audit report is given to the Minister, along with a response from the local government stating what action the local government has taken or intends to take with respect to each of those matters.

As the Department has yet to release a template for reporting this type of matter, I have simply provided the meeting minutes to address the requirements of the Act. Kindly note that Council endorsed the recommendations of the Audit Committee.

Briefly, the matters which were deemed to be significant by the Shire's auditor were:

- (i) adverse trends in the financial position or the financial management practices of the Shire of Gnowangerup:
 - a. Asset sustainability ratio as reported in Note 27 of the financial report of 0.65 is below the Department of Local Government, Sport and Cultural Industries (DLGSC) standard of 0.8 for the year ended 30 June 2018; and
 - b. Operating surplus ratio as reported in Note 27 of the financial report of (0.10) is below the Department of Local Government, Sport and Cultural Industries (DLGSC) standard of zero for the last three years.

The Shire's responses to these items can be found in the Comments section of the enclosed minutes.

For your information, I confirm that the Shire is aware that it has breached section 7.12A(4)(b) of the Act by not providing this report to the Minister within 3 months of receiving the audit report. Officers only became aware earlier this week that section 7.12A(4) had been activated, as they had previously been advised by the Shire's auditors that we had received an unqualified audit report.

The Shire of Gnowangerup takes its compliance responsibilities very seriously and is looking at ways to reverse the adverse trends in the relevant financial ratios.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'S Pike', written in a cursive style.

Shelley Pike
CHIEF EXECUTIVE OFFICER

29th March 2019

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5. URGENT BUSINESS INTRODUCED BY DECISION OF COMMITTEE

PROCEDURAL MOTION:

Moved: Cr C Thomas

Seconded: Cr L Martin

AC0319.02 That the urgent business of item 5.1 be considered at today's meeting.

UNANIMOUSLY CARRIED: 8/0

5.1	SIGNIFICANT MATTERS RAISED IN AUDIT
Location:	N/A
Proponent:	N/A
File Ref:	ADM0047
Date of Report:	26 th March 2019
Business Unit:	Corporate and Community Services
Officer:	V Fordham Lamont – Deputy CEO
Disclosure of Interest:	Nil

ATTACHMENTS

- Attachment 1 - Auditor's Report for the 2017/2018 Financial Year

PURPOSE OF THE REPORT

To provide the Audit Committee with a report addressing matters identified as "significant" in the 2017/2018 Audit Report, pursuant to section 7.12A of the *Local Government Act 1995*.

BACKGROUND

Section 7.2 of the *Local Government Act 1995* requires that the accounts and annual financial report of a local government for each financial year are to be audited by an auditor appointed by the local government.

Tim Partridge from AMD Chartered Accountants confirmed that the objectives of AMD's audit of the 2017/2018 financials were to obtain reasonable assurance about whether the financial report as a whole was free from material misstatement, whether due to fraud or error, and to issue an auditor's report that included AMD's opinion.

If an auditor identifies a major issue in the audit, the audit report will reflect that it is qualified and the local government is required to follow the process outlined in section 7.12A(4) and (5) of the *Local Government Act 1995*:

(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.

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(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.

AMD advised Officers that, as has been the case for several years, it had issued an unqualified report. The audited 2017/2018 Annual Financial Report, together with AMD's unqualified Auditor's Report, was presented to the Audit Committee on 28 November 2018 and adopted by Council at its Ordinary Meeting of the same date.

COMMENTS

On the 26 March 2019, the Department of Local Government, Sport and Cultural Industries (DLGSC) contacted the Shire to advise that, based on its recent dealings with local governments and the Office of the Auditor General (OAG), it felt compelled to advise that the word "significant" in relation to adverse trends for two financial ratios in the Auditor's Report, triggered the process referred to in section 7.12A(4) and (5) of the *Local Government Act 1995*.

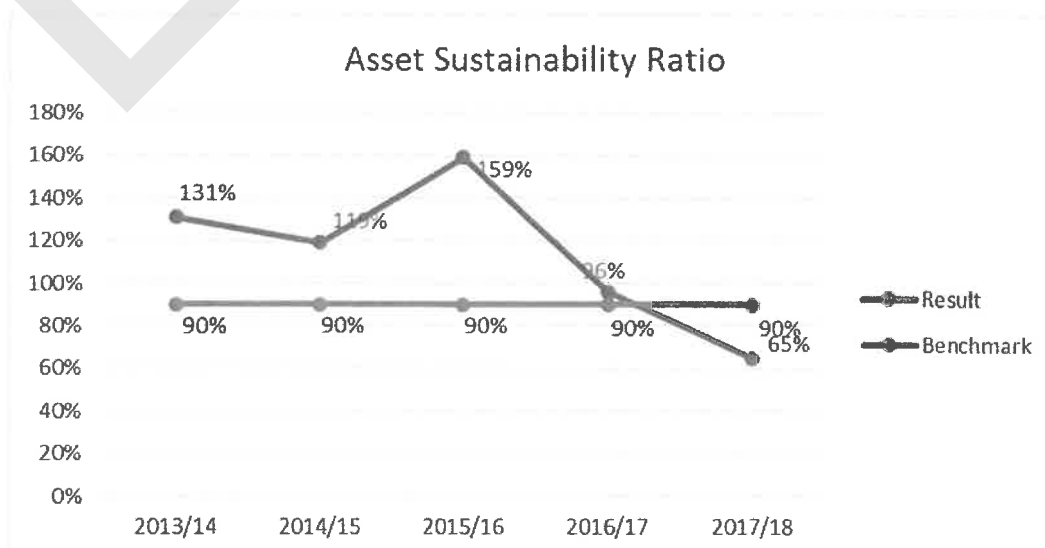
The significant adverse trends in the financial position or the financial management practices of the Shire of Gnowangerup referred to:

- (i) Asset sustainability ratio as reported in Note 27 of the financial report of 0.65 is below the Department of Local Government, Sport and Cultural Industries (DLGSC) standard of 0.8 for the year ended 30 June 2018; and
- (ii) Operating surplus ratio as reported in Note 27 of the financial report of (0.10) is below the Department of Local Government, Sport and Cultural Industries (DLGSC) standard of zero for the last three years.

Asset Sustainability Ratio (ASR)

The asset sustainability ratio indicates whether the Shire is replacing or renewing existing assets at the same rate that its overall asset stock is wearing out. The decrease in this ratio is attributable to the reduction in spend on capital renewal of assets, and an increase in depreciation booked for the year. The trend indicates Council is spending less on asset renewal when compared to what is being consumed (depreciated) of the asset base each year.

As with all ratios, when an adverse trend is identified, it should be investigated to see if there are other factors influencing the outcome of the ratio. The following graph shows the ASR results over the last 5 years.



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With the exception of 2017/18, 4 out of the last 5 years ratio results have been above the benchmark, although 2016/17 was low compared to the 3 previous years. It is quite evident that the effect of the Natural Disaster event in 2016/17 has had an impact on this ratio. It is well understood that Council's road network was significantly affected by the natural disaster event. To qualify for WANDRRA funding, Council was not able to conduct any of the reinstatement works itself, but had to engage contractors. Given the wide spread impact across the district, the Council workforce could do little capital works on roads – the majority of its work was on road maintenance. Further, all of the reinstatement works conducted by contractors had to be expensed, not capitalised. Therefore, from the fact that WANDRRA works impacted on the capital expenditure programs for 2016/17 and 2017/18, specifically capital renewal spend, it is obvious that the ASR would be adversely affected.

The ASR was further impacted by the increase in depreciation as a result of the introduction of Fair Value. The phased introduction of Fair Value of all Assets, resulted in Council increasing the value of its infrastructure assets on 30 June 2014. This caused a negative flow on effect to the amount of depreciation booked in 2015/16 due to the increase in carrying values of assets. This increased depreciation expense also applied to 2016/17 and 2017/18.

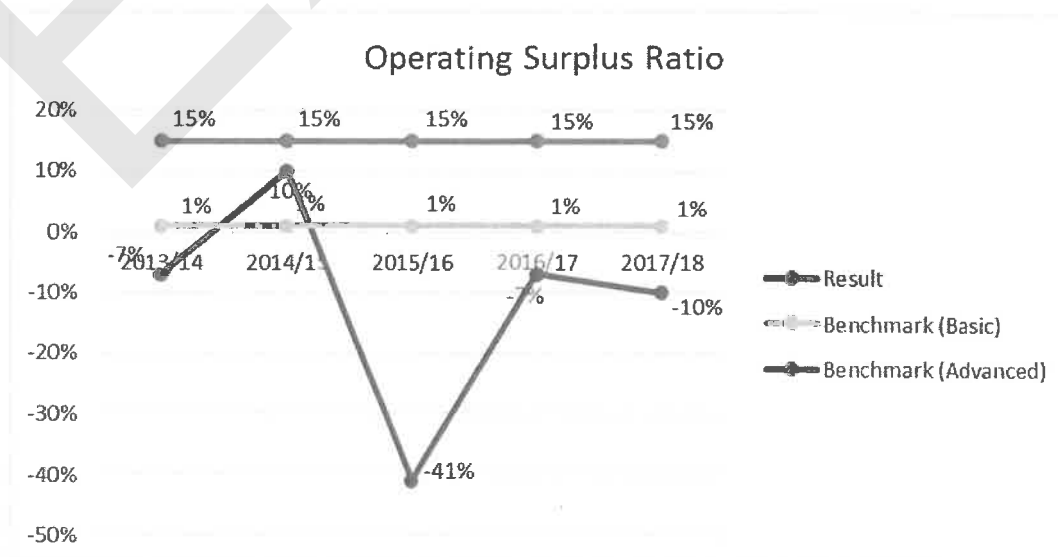
There was no action that Council could take in this instance to change/alter the ASR result.

It will be prudent for Council to monitor the ASR trends when the LTFP is reviewed in the coming months.

Operating Surplus Ratio (OSR)

The operating surplus ratio is a measure of the Shire's ability to cover its operational costs and have revenues available for capital funding or other purposes. The trend in this ratio is attributable to the reduction in operating grants and an increase in employee costs booked to operations.

As with all ratios, when an adverse trend is identified, it should be investigated to see if there are other factors influencing the outcome of the ratio. The following graph shows the OSR results over the last 5 years.



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This ratio is the most difficult to address, as it requires Council to ensure that its revenue sources grow at the same or a greater rate than its operating expenses, including depreciation. The phased introduction of Fair Value of all Assets, resulted in Council increasing the value of its infrastructure assets on 30 June 2014. This caused a negative flow on effect to the amount of depreciation booked in 2015/16 due to the increase in carrying values of assets. The impact of the increase in depreciation can be clearly seen in the 2015/16 negative spike in the graph above (it increased by over \$1M). It can be clearly seen that corrective measures were taken during 2016/17 and 2017/18 in an effort to address the negative impact of depreciation.

It is well known that most country local governments struggle to fully cash fund asset depreciation, as their revenue sources are limited. The only major source of funding that Council can control is rates. The challenge for Council to achieve a OSR result within the Benchmarks established by the Department of Local Government, Sports and Cultural Industries is striking a balance between how much of a rate burden should be placed on ratepayers, and how much of a reduction in service levels should occur to contain rising operating expenses.

Council will shortly be undertaking the annual review of its Long Term Financial Plan and will discuss strategies to improve these ratios. It is quite possible, however, that these ratios (particularly the Operating Surplus Ratio) will remain at levels below the "standard", due to cost pressures and limited revenue sources.

As the Auditor's Report was provided to the Shire on 20 November, 2018, Audit Committee members should note that the Shire is now outside the 3 month limit of providing a copy of this report to the Minister. It will still be reported to the Minister but Officers will also need to include this breach in the 2019 Compliance Audit Return.

CONSULTATION

Darren Long – Financial Services Consultant

LEGAL AND STATUTORY REQUIREMENTS

Local Government Act 1995

Section 7.2 Audit

Section 7.12A Duties of local government with respect to audits

POLICY IMPLICATIONS

Nil

FINANCIAL IMPLICATIONS

Nil

STRATEGIC IMPLICATIONS

Strategic Community Plan

Theme: Financial Sustainability

Objective: Effective management to conduct business in a financially sustainable manner

STRATEGIC RISK MANAGEMENT CONSIDERATIONS:

Nil

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IMPACT ON CAPACITY

Nil

ALTERNATE OPTIONS AND THEIR IMPLICATIONS

Nil

CONCLUSION

Officers are disappointed that AMD did not clearly highlight in its Auditor's Report, or discussions during and post audit, that the below-standard ratios constituted a trigger for the process described in section 7.12A(4) and (5) of the *Local Government Act 1995*.

The Audit Committee has the relevant information in relation to this matter and is encouraged to note the comments contained in this report, and recommend that Council accept the report, authorise the CEO to forward the report to the Minister, and notes that the Shire has breached section 7.12A(4)(b) of the *Local Government Act 1995*.

VOTING REQUIREMENTS

Absolute majority

COMMITTEE RESOLUTION:

Moved: Cr G Stewart

Seconded: Cr C Thomas

AC0319.03 That the Audit Committee:

1. Accept this report; and
2. Recommend to Council that it:
 - a. Accept this report;
 - b. Authorise the CEO to forward the report to the Minister; and
 - c. Note that the Shire has breached section 7.12A(4)(b) of the *Local Government Act 1995* by not forwarding the report to the Minister within 3 months of receiving the Auditor's Report for 2017/2018.

UNANIMOUSLY CARRIED: 8/0