

REPORT ON SIGNIFICANT MATTERS RAISED IN THE SHIRE OF NANNUP 2020/21 AUDIT

This report on significant matters raised in the Shire of Nannup (Shire) 2020/21 Audit has been prepared to satisfy the required of Section 7.12A(4) of the *Local Government Act 1995* which states:

“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”.*

In its 2020/21 Audit Report, the Auditor General raised the following significant matters:

1. The Asset Sustainability Ratio as reported in Note 27 of the annual financial report is below the Department of Local Government, Sport and Cultural Industries’ standard for the last three financial years.
2. The Operating Surplus ratio as reported in Note 27 of the annual financial report is below the Department of Local Government, Sport and Cultural Industries’ standard for the last three financial years.
3. The following material matters indicating non-compliance with Part 6 of the Act, the Regulations or applicable financial controls of any other relevant written law were identified during the course of my audit:
 - a. The Shire has not reported the Asset Renewal Funding Ratio for 2021, 2020 and 2019 in the annual financial report as required by section 50(1) of the *Local Government (Financial Management) Regulations 1996*, as management could not confirm the reliability of the available information on planned capital renewals and required capital expenditure in the long-term financial plan and asset management plan respectively.
 - b. Reconciliations for property, plant and equipment, and infrastructure were not being performed. Reconciliations are a key control for ensuring the completeness and accuracy of financial data within the general ledger and the information reported in the financial statements.

Matter 1 – Asset Sustainability Ratio

The Audit Report includes a statement that the Shire’s Asset Sustainability Ratio has been below the Department of Local Government, Sport and Cultural Industries’ standard for the past three years.

In considering this issue, it should be noted that there is no legislative basis upon which the Department can prescribe standards for financial ratios against which local governments are to be assessed and report. Further, Regulation 10(3)(e) of *the Local Government (Audit) Regulations 1996* only requires local government auditors to express an opinion on whether or not a local government's asset consumption and asset renewal funding ratios are supported by verifiable information and reasonable assumptions. In this regard, the Audit Report states:

"In my opinion, the Asset Consumption Ratio included in the financial report were supported by verifiable information and reasonable assumptions."

The Asset Sustainability 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 Asset Sustainability Ratio is determined as follows:

$$\text{Asset Sustainability Ratio} = \frac{\text{Capital renewal and Replacement expenditure}}{\text{Depreciation}}$$

According to the Department's Guideline, the "standard" is met if the ratio is at least 0.90. The Shire's asset sustainability ratios for 2019, 2020 and 2021 were 0.55, 0.47 and 0.45.

To address the adverse trend in the Shire's asset sustainability ratio, the Shire will look to attempt to expend funds on renewal and replacement of assets at a higher level over subsequent financial years.

Matter 2 – Operating Surplus Ratio

The Audit Report includes a statement that the Shire's Operating Surplus has been below the Department of Local Government, Sport and Cultural Industries' standard for the past three years.

In considering this issue, it should be noted that there is no legislative basis upon which the Department can prescribe standards for financial ratios against which local governments are to be assessed and report. Further, Regulation 10(3)(e) of *the Local Government (Audit) Regulations 1996* only requires local government auditors to express an opinion on whether or not a local government's asset consumption and asset renewal funding ratios are supported by verifiable information and reasonable assumptions. In this regard, the Audit Report states:

"In my opinion, the Asset Consumption Ratio included in the financial report were supported by verifiable information and reasonable assumptions."

The Operating Surplus Ratio is a measure of a local government's ability to cover its operational costs and have revenues available for capital funding and other purposes. The Operating Surplus Ratio is determined as follows:

$$\text{Operating Surplus Ratio} = \frac{\text{Operating revenue} - \text{Operating expenditure}}$$

Own source operating revenue

According to the Department's Guideline, the "standard" is met if the ratio is at least 0.01. The Shire's operating surplus ratios for 2019, 2020 and 2021 were (0.25), (0.40) and (0.46), respectively. A negative ratio, as has been the case at the Shire for the past three years, indicates that a local government does not generate sufficient own source revenue to cover its operating costs.

To address the adverse trend in the Shire's operating surplus ratio, the Shire will develop a rating strategy and review its rates modelling over subsequent financial years.

Matter 3 – Asset Renewal Funding Ratio

The Auditor General reported that:

The following material matters indicating non-compliance with Part 6 of the Act, the Regulations or applicable financial controls of any other relevant written law were identified during the course of my audit:

- a. *The Shire has not reported the Asset Renewal Funding Ratio for 2021, 2020 and 2019 in the annual financial report as required by section 50(1) of the Local Government (Financial Management) Regulations 1996, as management could not confirm the reliability of the available information on planned capital renewals and required capital expenditure in the long-term financial plan and asset management plan respectively."*

The Shire are in the process of updating the Long Term Financial Plan (LTFP) and the Asset Management Plan (AMP) which are part of the integrated planning and reporting framework.

When the LTFP and the AMP are updated, the Shire will review on an annual basis as part of the annual budget process.

Matter 4 – Fixed Asset Reconciliation

The Auditor General reported that:

The following material matters indicating non-compliance with Part 6 of the Act, the Regulations or applicable financial controls of any other relevant written law were identified during the course of my audit:

- b. *Reconciliations for property, plant and equipment, and infrastructure were not being performed. Reconciliations are a key control for ensuring the completeness and accuracy of financial data within the general ledger and the information reported in the financial statements."*

The Shire will implement a monthly reconciliation between the fixed assets register and the general ledger.