

**SHIRE OF BROOKTON**

**AUDIT COMMITTEE MEETING**

**AGENDA**

**Thursday 17 November 2016**



**11:00 am      COMMENCEMENT OF MEETING**

**Shire of Brookton**  
**Audit Committee Meeting**  
**Notice of Meeting**

Notice is hereby given that a meeting of the Audit Committee will be held on Thursday 17 November 2016, in the Council Chambers of the Shire Administration Centre, commencing at 11:00 am.

The business to be transacted is shown in the Agenda.



**Dale Stewart**  
**Acting Chief Executive Officer**  
11 November 2016

## TABLE OF CONTENTS

1.11.16	DECLARATION OF OPENING/ATTENDANCE .....	4
2.11.16	ANNOUNCEMENTS OF VISITORS .....	4
3.11.16	RESPONSE TO PREVIOUS PUBLIC QUESTIONS TAKEN ON NOTICE	4
4.11.16	PUBLIC QUESTION TIME .....	4
5.11.16	APPLICATIONS FOR LEAVE OF ABSENCE .....	4
6.11.16	PETITIONS/DEPUTATIONS/PRESENTATIONS .....	4
7.11.16	CONFIRMATION OF MINUTES OF PREVIOUS MEETINGS .....	5
8.11.16	ANNOUNCEMENTS BY THE PRESIDING MEMBER WITHOUT DISCUSSION.....	5
9.11.16	DISCLOSURE OF INTERESTS.....	5
10.11.16	ANNUAL REPORT FOR 2015/16 FINANCIAL YEAR.....	6
11.11.16	CLOSURE .....	13

## **1.11.16 DECLARATION OF OPENING/ATTENDANCE**

The Presiding Member opened the meeting at ... pm and welcomed Councillors and Staff.

### **Attendance**

#### Elected Members (Voting)

Cr KT Wilkinson                      Shire President (Presiding Member)  
Cr KL Crute  
Cr NC Walker  
Cr KH Mills  
Cr L Allington  
Cr T Fancote  
Cr T Eva

#### Staff (Non Voting)

Dale Stewart                      Acting Chief Executive Officer  
Peter Kocian                      Acting Deputy Chief Executive Officer  
Courtney Fulwood                Acting Executive Support and Administration Officer

#### Members of the Public

#### Apologies

#### Leave of Absence

## **2.11.16 ANNOUNCEMENTS OF VISITORS**

The Presiding Member welcomed Greg Godwin, the Shire's independent Auditor from Moore Stephens to the Audit Committee meeting, who was attending via telephone.

## **3.11.16 RESPONSE TO PREVIOUS PUBLIC QUESTIONS TAKEN ON NOTICE**

Nil

## **4.11.16 PUBLIC QUESTION TIME**

## **5.11.16 APPLICATIONS FOR LEAVE OF ABSENCE**

## **6.11.16 PETITIONS/DEPUTATIONS/PRESENTATIONS**

**7.11.16 CONFIRMATION OF MINUTES OF PREVIOUS MEETINGS**

**OFFICER RECOMMENDATION**

That the Audit Committee minutes from 18 February 2016, be confirmed as true and correct record of the proceedings.

***SIMPLE MAJORITY VOTE REQUIRED***

**8.11.16 ANNOUNCEMENTS BY THE PRESIDING MEMBER WITHOUT DISCUSSION**

**9.11.16 DISCLOSURE OF INTERESTS**

***Members and Officers to declare Financial, Proximity or Impartiality Interests & submit forms to the Chief Executive Officer at the commencement of the meeting and also prior to the item.***

**Disclosure of Financial & Proximity Interests**

- a. Members must disclose the nature of their interest in matters to be considered at the meeting. (Sections 5.60B and 5.65 of the *Local Government Act 1995*).
- b. Employees must disclose the nature of their interest in reports or advice when giving the report or advice to the meeting. (Sections 5.70 and 5.71 of the *Local Government Act 1995*).

**Disclosure of Interest Affecting Impartiality**

- a. Members and staff must disclose their interest in matters to be considered at the meeting in respect of which the member or employee has given or will give advice.

**Financial, Proximity and Impartiality Interests**

<b>Item no.</b>	<b>Members</b>	<b>Type of Interest</b>	<b>Nature of Interest</b>

## 10.11.16 ANNUAL REPORT FOR 2015/16 FINANCIAL YEAR

File No: 1338  
Applicant/ Proponent: Shire of Brookton  
Subject Land/ Locality: Not Applicable  
Date: 10/11/2016  
Author: Peter Kocian, Acting Deputy Chief Executive Officer  
Authorising Officer: Dale Stewart, Acting Chief Executive Officer  
Disclosure of Interest from Author: Neither the Officer nor Authorising Officer have any impartiality, Financial or Proximity Interest that requires disclosure.  
Authority/Discretion:  Executive – the substantial direction setting and oversight role of the Council. E.g. adopting plans and reports, accepting tenders, directing the Chief Executive Officer, setting and amending budgets.

### Attachments:

1. Annual Report for the 2015/16 Financial Year (Separate Attachment)
2. Independent Auditor's Report and Management Report for the Year Ended 30 June 2016 (Separate Attachment)

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### OFFICER RECOMMENDATION

**That with respect to 2015/16 Annual Report, that the Audit Committee recommend to Council that the Council;**

- 1. Adopt the 2015/16 Annual Report including the Independent Audit Report from Moore Stephens as presented under separate cover, pursuant to section 7.2 of the *Local Government Act 1995* and;**
- 2. Receive the Management Report from Moore Stephens for the Year Ended 30 June 2016.**

***ABSOLUTE MAJORITY VOTE REQUIRED***

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### SUMMARY

Council's Auditor, Moore Stephens, has provided Council with the Audit and Management Report for the financial year ended 30 June 2016.

### BACKGROUND

Pursuant to sections 7.2, 7.3 and 7.9 of the *Local Government Act 1995*, local governments are required each year to have the accounts and annual financial report audited by an auditor appointed by the local government.

The on-site audit was conducted on the 6/7 October 2016 with the Annual Financial Report finalized and submitted to the Auditors on Friday 28 October 2016 following post audit adjustments including a reworking of depreciation expense on infrastructure assets. The Auditor's Report and Management Report was received on

8 November 2016, and is presented under separate cover as attachment 2 to this report.

An Annual Report has also be prepared containing information prescribed under section 5.53 of the *Local Government Act 1995* including the following:

- A report from the President
- A report from the Chief Executive Officer
- An overview of the Strategic Community Plan and Corporate Business Plan
- The financial report for the financial year
- The auditor's report for the financial year

## COMMENT

The Shire of Brookton has received an unqualified audit opinion on its annual financial report which indicates that the Shire's financial statements are an accurate presentation of its financial position. In particular the auditor has noted that the financial report of the Shire of Brookton:

- (i) Gives a true and fair view of the financial position of the Shire of Brookton as at 30 June 2016 and of its financial performance for the year ended on that date;
- (ii) Complies with the *Local Government Act 1995* Part 6 and the Regulations under that Act and Australian Accounting Standards (including the Australian Accounting Interpretations); and
- (iii) The calculations to the Asset Consumption Ratio and Asset Renewal Funding Ratio have been reviewed and are based on verifiable information and reasonable assumptions.

The annual financial report demonstrates that the Shire's financial position is sound as at 30 June 2016, reflected by the following key indicators:

- Cash and cash equivalents of \$3,994,827 (Current Ratio of 1.15)
- Long term borrowings of \$1,607,790 (Debt Service Cover Ratio of 3.41)
- Total fixed assets of \$90m + (Asset Consumption Ratio of 70%)
- Carried forward surplus of \$572,848
- Adjusted own-source revenue coverage ratio of 73%

Moore Stephens have issued a Management Report which provides specific comment on statutory ratios. This information is repeated below:

	Target Ratio <sup>1</sup>	Actual 2016	Council's Adjusted Ratios					Council's 5 Year Trend <sup>2</sup>	4 Year Average <sup>3</sup>	
			2016	2015	2014	2013	2012		Regional	State
Current Ratio	≥ 1	1.15	1.15	1.17*	1.03	0.94	0.70	↑	2.48	2.29
Asset Sustainability Ratio	≥ 1.1	0.64	0.64	0.98	2.53	2.27	2.07	↓	1.38	1.23
Debt Service Cover Ratio	≥ 15	3.41	5.35*	5.32*	6.26*	2.48*	5.00	↑	11.82	14.01
Operating Surplus Ratio	≥ 0.15	(0.46)	(0.34)*	(0.05)*	0.04*	(0.23)*	(0.02)	↓	(0.08)	(0.02)
Own Source Revenue Coverage Ratio	≥ 0.9	0.43	0.73*	0.84*	0.83*	0.77*	0.78*	↓	0.56	0.68
Asset Consumption Ratio	≥ 0.75	0.70	0.70	0.64	0.68	0.57	N/A	↑	0.77	1.16
Asset Renewal Funding Ratio	≥ 1.05	0.81	0.81	0.66	1.11	0.88	N/A	↓	0.97	1.00

<sup>1</sup> Target ratios per Department of Local Government and Communities (DLGC) Guidelines except the Debt Service Ratio which is a target devised by Moore Stephens (and based on experience). For information, DLGC Guidelines indicate a target Debt Service Cover Ratio of 5.

<sup>2</sup> The 5 year trend compares the adjusted 2016 ratios to the average of the adjusted ratios for the last 5 years (except for the Asset Consumption and Asset Renewal Funding Ratios which are the 4 year trend).

<sup>3</sup> The average in relation to the Regional and State comparisons is a 4 year average of 2012, 2013, 2014 and 2015.

\* Adjusted for "one-off" timing/non-cash items.



### **Adjustment relating to 2016**

Three (2015 – Four) of the ratios in the accompanying table have been adjusted for “one off” timing/non-cash items as follows:

- The Debt Service Cover and Operating Surplus ratios were distorted by the early receipt of half of the allocation of the 2015-2016 Financial Assistance Grant (FAGs) on 30 June 2015. The early payment of the grant increased operating revenue in 2015 and decreased operating revenue in 2016 by \$474,081.
- The Own Source Revenue Coverage ratio was distorted by the operating grant component of \$2,695,871 relating to the Kalkarni Aged Care Facility not being treated as Own source operating revenue in accordance with the Department of Local Government ratio guidelines.

All of these amounts were adjusted when calculating the ratios in the above table (as shown by “\*”) as were comparative year ratios which had also been affected by similar “one off” / “Non-cash” items.

### **Regional and State 4 Year Averages**

Regional and State 4 year averages have not been adjusted for these items even though “one-off” items may have been applicable in prior years as they are based on the statutory ratios which have been reported in published financial reports. However, they still provide a useful reference point as they are indicative of the trend.

### **Commentary on specific ratios:**

#### **• Asset Sustainability Ratio**

The Asset Sustainability ratio (ASR) expresses capital expenditure on renewal and replacement of existing assets as a percentage of depreciation costs. This ratio is used to identify any potential decline or improvement in asset conditions. A percentage of less than 100% on an ongoing basis indicates assets may be deteriorating at a greater rate than spending on renewal or replacement.

This ratio is below the target level and both Regional and State 4 year averages and is trending downwards against the average over the last five years.

The reason for the deterioration in this ratio is a combination of the increase in depreciation expense following the revaluation of infrastructure assets during the year ended 30 June 2015 and capital renewal and replacement expenditure being under budget during the year ended 30 June 2016.

Interpretation of this ratio should be considered together with the Asset Consumption Ratio (ACR) (within target level at 0.70) and the Asset Renewal Funding Ratio (ARF) (within target level at 0.81).

The downward trend should prompt a review of the depreciation calculations along with reviewing the Shire’s long term capital investment program to help ensure asset renewal is maintained at an appropriate level with sufficient funding support in the future.

#### **• Debt Service Cover Ratio**

The Debt Service Cover Ratio measures Council’s ability to service debt out of its uncommitted or general purpose funds available from its operations.

This ratio is below the target level and both Regional and State 4 year averages but is trending upwards against the average over the last five years.

Based on our experience a Local Government of your circumstances with a Debt Service Ratio consistently below 15 would be experiencing difficulty in maintaining their assets and service level over the medium and longer term.

Analysis of the level of this ratio in relation to Council’s cash flows, financial position and the other ratios would indicate budgeted levels of the Shire’s capital investment program are not attainable at the current operating surplus and debt levels.

Notwithstanding this, as overall debt levels appear reasonable when compared to other Councils of similar circumstances, improvement of the operating surplus in the short term rather than the current debt level should be the subject of review.

- **Operating Surplus Ratio**

The Operating Surplus Ratio represents the percentage by which the operating surplus (or deficit) differs from the Shire's own source revenue which includes rates and operating grants.

This ratio has decreased significantly in the current year and is trending downwards over the last five years. Furthermore, it is currently below the target level and both the Regional and State 4 year averages.

Analysis of the Shire's Statement of Comprehensive Income indicates the main reason for the deterioration of the ratio to be the increase in operating expenditure associated mainly with the increase in depreciation (the resultant effect of the revaluation of infrastructure assets during the year ended 30 June 2015) not being matched by an increase in operating revenue during the year ended 30 June 2016. If depreciation was at similar levels to the year ended 30 June 2015, then this ratio would have been more in the vicinity of a positive result.

Both Council and Management will need to consider ways to improve the operating surplus position further either via increasing revenue or by decreasing expenditure (or a combination of both). This will be dependent upon Council and management's understanding of the Shire's circumstances and the interaction between the operating surplus and the other ratios and operations in general.

#### **Summary**

The Shire's ratio position, after adjustment for depreciation and the FAGs and the Kalkarni Aged Care Facility operating grants detailed above are factored in, appears reasonably consistent with prior years.

Notwithstanding this, as all the ratios except the current ratio are below the accepted industry benchmark and a number of the ratios are trending downwards over the longer term, moving forward, measures/strategies to reverse the downward trends and improve the overall level of the ratios should be considered.

We would also like to take this opportunity to stress one-off assessments of ratios at a particular point in time can only provide a snapshot of the financial position and operating situation of the Shire. As is the case with all ratios and indicators, their interpretation is much improved if they are calculated as an average over time with the relevant trends being considered.

We will continue to monitor the financial position and ratios in future financial years and suggest it is prudent for Council and management to do so also as they strive to manage the scarce resources of the Shire.

#### **Officer Comment:**

The Department of Local Government and Communities has developed the My Council website ([mycouncil.wa.gov.au](http://mycouncil.wa.gov.au)) which provides an assessment of all local governments in Western Australia. One of the key measures assessed is the Financial Health Indicator (FHI) score which is a measurement of a local governments overall financial health. It is calculated from the seven financial ratios that local governments are required to calculate annually and disclose in the Annual Financial Report. An FHI result of 70 and above indicates sound financial health. The maximum result achievable is 100.

The Department assessed the Shire of Brookton's FHI to be 87 in 2014/15. However, the FHI score is likely to fall to about 61 in 2015/16 as a result of declining ratios, specifically the Asset Sustainability Ratio (ASR). The ASR expresses capital expenditure on renewal and replacement of existing assets as a percentage of depreciation costs. A percentage of less than 100% on an ongoing basis indicates

assets may be deteriorating at a greater rate than spending on renewal or replacement.

The Shire's ratio of 0.64 is below the target level and both Regional and State 4 year averages and is trending downwards. In order to improve overall financial sustainability, the Shire of Brookton will be required to improve its operating surplus position by a combination of any of the following strategies:

- Increase own source operating revenue such as rates, fees and charges and commercial revenue streams;
- Decrease operating expenditure with a specific focus on large expenditure areas;
- Review service levels and identify if any efficiencies can be achieved on the current service delivery model;
- Review the economic life of assets and depreciation calculations to ensure that the annual depreciation expense reflects the true consumption rate of assets.

Ultimately, the Shire's Long Term Financial Plan will need to be reviewed to incorporate the above strategies, with the statutory ratios to be calculated over a ten year horizon to assess an upwards trend.

The Shire's Auditor, Greg Godwin (Partner, Moore Stephens) will be attending the Audit Committee via teleconference to provide advice on matters relating to the Auditor's Report and Management Report.

## CONSULTATION

- Shire's Auditor's, Moore Stephens
- Chief Executive Officer
- Senior Staff

## LEGISLATIVE IMPLICATIONS

Section 7.2, 7.3 and 7.9 of the *Local Government Act 1995* prescribe requirements with regards to Audit.

The annual financial report is prepared in accordance with Australian Accounting Standards, the *Local Government Act 1995*, and the *Local Government (Financial Management) Regulations 1996*.

Section 5.53 of the *Local Government Act 1995* (the Act) outlines the requirements of an Annual Report. Section 5.54 states that a local government must accept an annual report by 31 December of each year by absolute majority.

## POLICY IMPLICATIONS

There are no Council Policy implications that are relevant to this item.

## FINANCIAL IMPLICATIONS

The availability of the Annual Report and the date for the annual general meeting of electors will be advertised in the Brookton Telegraph Notes. There will be no cost associated with this.

A limited number of hard copy annual reports will be printed and funded under the existing stationery budget.

## STRATEGIC IMPLICATIONS

Pursuant to the Strategic Community Plan, the Shire is to provide high quality corporate governance, accountability and compliance.

## SUSTAINABILITY IMPLICATIONS

### *Environmental*

There are no significant identifiable natural or built environmental impacts arising from adoption of the officer's recommendation.

### *Economic*

There are no significant identifiable economic impacts arising from adoption of the officer's recommendation.

### *Social*

There are no significant identifiable social impacts arising from adoption of the officer's recommendation.

### *Risk*

Risk	That the Audit Committee refuse to adopt the Annual Report.
Risk Likelihood (based on history and with existing controls)	Rare (1)
Risk Impact / Consequence	Insignificant (1)
Risk Rating (Prior to Treatment or Control)	Low (1-4)
Principal Risk Theme	Failure to fulfil Compliance requirements
Risk Action Plan (Controls or Treatment proposed)	Accept Officer Recommendation

### Risk Matrix

Consequence Likelihood		Insignificant	Minor	Moderate	Major	Catastrophic
		1	2	3	4	5
Almost Certain	5	Medium (5)	High (10)	High (15)	Extreme (20)	Extreme(25)
Likely	4	Low (4)	Medium (8)	High (12)	High (16)	Extreme(20)
Possible	3	Low (3)	Medium (6)	Medium (9)	High (12)	High (15)
Unlikely	2	Low (2)	Low (4)	Medium (6)	Medium (8)	High (10)
Rare	1	Low (1)	Low (2)	Low (3)	Low (4)	Medium (5)

A risk is often specified in terms of an event or circumstance and the consequences that may flow from it. An effect may be positive, negative or a deviation from the expected and may be related to the following objectives; occupational health and safety, financial, service interruption, compliance, reputation and environment. A risk matrix has been prepared and a risk rating of 1 has been determined for this item. Any items with a risk rating over 10 (considered to be high or extreme risk) will be added to the Risk Register, and any item with a risk rating over 17 will require a specific risk treatment plan to be developed.

## CONCLUSION

The adoption of the Annual Report is a legislative requirement. Officers' have complied with the statutory timeframe in preparing the Annual report for adoption before 31 December 2016.

### 11.11.16 CLOSURE

There being no further business to discuss, the Presiding Member closed the meeting at ... am.