SHIRE OF MUKINBUDIN
2017-2018 ANNUAL FINANCIAL STATEMENTS
SIGNIFICANT ADVERSE TRENDS

Summary
The 2017-2018 Independent Audit Report has identified a significant adverse trend in the financial position of the shire.

This adverse significant trend is that the Asset Sustainability and Operating Surplus ratios have been below the Department of Local Government, Sport and Cultural Industries (DLGSCI) standard for those ratios for past 3 years as reported in the financial report.

The DLGSCI standard for the Asset Sustainability Ratio is 0.90 or greater. The Shire of Mukinbudin's Asset Sustainability Ratio for the last 3 years has been:

- 2016 – 0.81
- 2017 – 0.58
- 2018 – 0.78

Council and management have reviewed the Asset Sustainability Ratio and the factors determining this. It has been concluded that reasonably available financial resources and other external factors and concluded that although some improvement is expected in 2018/2019 and a reallocation of resources from maintenance to renewal where possible in the future it may not be possible to achieve or maintain the minimum standard due to a limited rate base and a reliance on external funding beyond councils control.

The DLGSCI standard for the Operating Surplus Ratio is 0.01 or greater. The Shire of Mukinbudin's Operating Surplus Ratio for the last 3 years has been:

- 2016 – (0.09)
- 2017 – (0.05)
- 2018 – (0.77)

Figures in () are negative.

Council and management have reviewed the Operating Surplus Ratio and the factors determining this.

It has been concluded that although some improvement is expected in 2018/2019 with the limited ratepayer base it will not be possible to achieve the minimum standard without significant additional untied external funding.

The alternatives of a publicly unacceptable rate increase up to 100% and/or an unworkable decrease in service and compliance levels to save up to $1,500,000 in operating expenditure are not considered to be viable options.

Asset Sustainability Ratio

$$\text{Asset Sustainability Ratio} = \frac{\text{Capital Renewal and Replacement Expenditure}}{\text{Depreciation}}$$

Capital Renewal and Replacement Expenditure

Council has limitations on how many financial resources can be allocated to capital renewal and replacement expenditure. These are a:

- Limited ratepayer base and a high dependence upon external grants to fund capital expenditure.
- Constant financial demand to "maintain" assets to keep the service level acceptable.

Although council plans to increase some council rates by over twice the CPI in 2019-2020 this will have little impact in available funds available for capital renewal and replacement expenditure compared to what is required to substantially improve the ratio due to the small ratepayer base and the increase in state government fees in charges.

The constant financial demand to "maintain" assets is best demonstrated by taking council's major asset of 935 km of road infrastructure as an example. This was valued at $70,413,568 before depreciation at 30 June 2018. As the vast majority of the roads are unsealed significant and regular maintenance is required to keep the roads safe and trafficable.

Road maintenance expenditure to 30 June 2018 totalled over $410,000. As this does not extend the life of the asset up to that which it had originally it is recorded as operating expenditure. However, without this "maintenance" the life of the asset would be significantly shortened.

Depreciation

Other than prudent control of depreciation rates there is little council control over the reported figure. Council reviews depreciation rates annually.

However, revaluations can have a very significant impact. For example:

- At 30 June 2017 buildings were revalued and useful lives and depreciation reset reducing building depreciation by approximately $136,000 in 2017/2018.
- At 30 June 2018 infrastructure was revalued and useful lives and depreciation reset reducing road infrastructure depreciation by approximately $80,000 in 2018/2019 largely due to reduced road infrastructure values.

As a result total annual depreciation decreased by approximately $448,000 or about 20% from the 2016-2017 year to the 2018-2019 year significantly improving the ratio without any significant action by council.

Operating Surplus Ratio

$$\text{Operating Surplus Ratio} = \frac{\text{(Operating Revenue MINUS Operating Expense)}}{\text{Own Source Operating Revenue}}$$

For this ratio to become positive, rather than negative, as it is now, it is necessary for Operating Revenue to exceed Operating Expense.

Operating Revenue

“Operating Revenue” excludes grants and contributions for the development or acquisition of assets.

Operating revenue includes rates, fees & charges and operating grants. The only income the council can control is rates, fees and charges. Based on the audited 2017-2018 figures all rates, fees and charges would have to increase by over 75%, if rates alone were to correct the situation, they would have to increase over 120%. Increases of this magnitude are clearly unacceptable and unaffordable to the ratepayers and council’s customers.

The only practical way that this ratio could be become positive in the foreseeable future would be if the untied operational grants were increased by at least 100%

Operating Expense

A major component of Council’s Operating Expense is depreciation, this makes up almost 30% of councils operating expenditure. As discussed in the Asset Sustainability Ratio discussion this is largely beyond council’s control and subject to significant changes from year to year.

Another 8% is spent on essential road maintenance.

If a reduction in operating expenses alone is made in order to meet the essential target for the Operating Surplus Ratio the reduction in operating expenditure would be to be approximately $1,468,000. This could not be achieved without impacting on Council’s ability to meet its essential responsibilities and legal compliance obligations.

Own Source Operating Revenue

Own Source Operating Revenue is revenue from rates and service charges, fees and user charges, reimbursements and recoveries, interest income and profit on disposal of assets. This in the only component of the ratio that is subject to significant Council control.

Changes in this figure will change the magnitude of the ratio however to it is essential that Operating Revenue exceed Operating Expense for the Operating Surplus Ratio meet the DLGSCI minimum standard.

Operating Surplus Ratio Final Approach

The following alternatives have been considered:

a) A publicly unacceptable rate increase.

and/or

b) An unworkable decrease in service and compliance levels to reduce operating expenditure.

or

c) Accepting that the in the foreseeable future Operating Surplus Ratio will be reported as having a significant adverse trend.

After considering these options it is considered that the best way council can serve its community and visitors is to accept that in the foreseeable future Operating Surplus Ratio will be reported as having a significant adverse trend.