



All correspondence to be addressed to:
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18 May 2020

Minister David Templeman
Minister for Local Government; Heritage; Culture and the Arts
7th Floor, Dumas House, 2 Havelock Street
WEST PERTH, WA 6005

Dear Minister Templeman,

RE: 2018-19 AUDIT REPORT – SIGNIFICANT ITEMS REPORTED IN THE ANNUAL REPORT

I write to address matters identified in the Kulin Shire Council audit of the 2018/19 Annual Financial Report, which was finalised by the Office of the Auditor General (OAG) on 30 March 2020. The Annual Report was presented to the Audit Committee followed by a Special Council Meeting held at 3:00pm Wednesday 1 April 2020. The audit opinion described significant adverse trends and matters of non-compliance with the Local Government (Financial Management) Regulations 1996. These matters are:

1. The Shire's Asset Consumption Ratio over the last three years has been 0.68, 0.70 and 0.68 compared to the Department's standard ratio of 0.50.; and
2. A significant adverse trend in the financial position of the Shire with specific regard to the Operating Surplus Ratio being below the Department of Local Government, Sport and Cultural Industries (the Department) standard for the past three years.

Further information was presented to Council at its an Audit Committee Meeting and Ordinary Council Meeting on Wednesday 15th February 2020 outlining Council's proposed response.

Section 7.12 (4) of The Local Government Act 1995 requires a Local Government to prepare a report addressing matters identified as significant by the auditors and to state what action the local government has taken or intends to take with respect to each of those matters.

The following outlines the response reported to Council with regard to these matters.

Asset Sustainability Ratio

This ratio indicates whether the Shire is renewing or replacing existing nonfinancial assets at the same rate that its overall stock of assets is wearing out. It is calculated by measuring capital expenditure on renewal and replacement of assets relative to the rate of depreciation of assets for the same period. The Department of Local Government, Sport and Cultural Industries (the Department) Standard is met if the ratio can be measured and is 90% (or 0.90). The standard is improving if this ratio is between 90% and 110% (or 0.90 and 1.10).

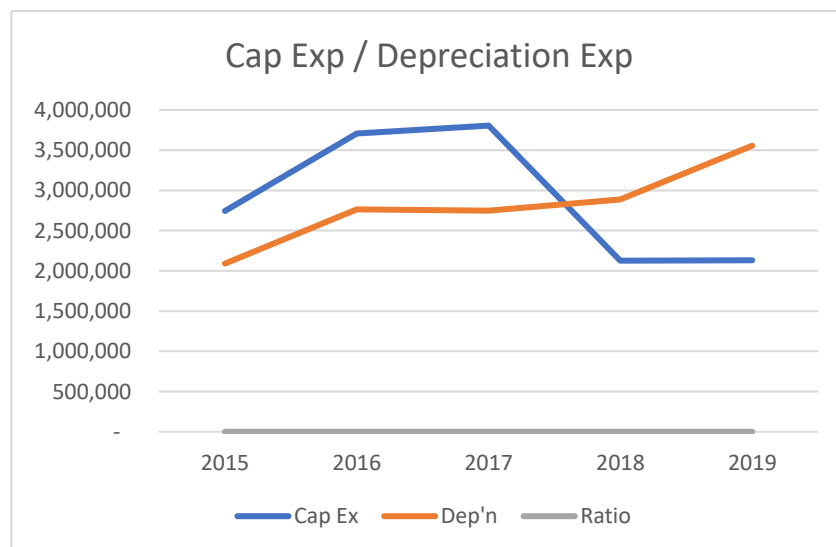
The following table outlines the Shire of Kulin's total 'renewal/replacement' capital purchases compared to depreciation expense over the last five years. In 2016 and 2017 the Federal Government increased the R2R program funding by double which resulted in the Shire having



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to spend significantly more on road construction for those years. Regardless of the additional expenditure we would have met the Department's benchmark of 0.90 in these years. The impact of depreciation in the years following revaluations have negatively impacted this ratio and in particular the increase in depreciation following the infrastructure valuations in 2018.

Year	Cap Ex	Dep'n	Ratio	Comments
2019	2,130,098	3,555,499	0.60	
2018	2,126,798	2,886,530	0.74	Roads revalued, impact on dep'n in subsequent years
2017	3,805,848	2,749,106	1.38	Double allocation of R2R funding
2016	3,708,288	2,766,130	1.34	Double allocation of R2R funding
2015	2,745,520	2,090,512	1.31	Roads revalued, impact on dep'n in subsequent years



The Shire's Asset Consumption Ratio over the last three years has been 0.68, 0.70 and 0.68 compared to the Department's standard ratio of 0.50. The Department's Operational Guideline indicates that 'This ratio seeks to highlight the aged condition of a local government's stock of physical assets.' The Shire's ratio result shows that our physical assets are only 32% consumed and therefore you might consider our group of assets to be in relatively good



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condition. While we are not replenishing the assets (capital expenditure) which we consume (depreciate) during the year the assets are relatively new and in good condition.

Action:

Depreciation expense is based on accounting estimates and, after an increase in valuation in 2015 of \$16m and in 2018 of \$30m, it may indicate that the depreciation rates being used are too high. If depreciation rates were correct you would not expect that after 3 years (2015 - 2018) the road valuation could increase by much more than CPI. The large increase could also indicate anomalies in valuation methodology in either the 2013, 2018 or both valuation processes that require further investigation and interrogation. The Asset Management Plan is in the process of being reviewed and in conjunction with this process we will be revaluing all classes of assets. Valuation methodology related to infrastructure and depreciation rates will be scrutinised to ensure accuracy.

Operating Surplus Ratio

In the Local Government Operational Guidelines Number 18 the Department described the Operating Surplus Ratio as a financial performance ratio which is a key indicator of a local government's financial sustainability.

The Operating Surplus Ratio is calculated by:

$$\frac{\text{(Operating Revenue-Operating Expenditure)}}{\text{Own Source Revenue}}$$

Own Source Revenue

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.

Standard:

Basic Standard between 1% and 15% (0.01 and 0.15) Advanced Standard > 15% (>0.15).

Comment:

The depreciation expense posted each year has a significant impact on our operating result and we consistently post a loss based on this expense. As you can see in the table below we were achieving the standard in 2015 prior to the first round of infrastructure valuations impacting depreciation. In order to achieve the basic standard of this ratio we need a profit result equal to or higher than 10% of our own source revenue. The first challenge will be posting a profit result, the second will be achieving a profit level high enough to achieve the minimum standard.



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2017/2018

	2019	2018	2017	2016	2015
Operating Surplus Ratio	(0.41)	(0.46)	(0.13)	(0.39)	0.051

Action:

During 2019/2020 we are reviewing our Asset Management Plan and our Long Term Financial Plan. In addition to this, and in conjunction with the review of our Asset Management Plan, we will be conducting revaluations on each of the levels of assets. We will do some analysis on appropriate depreciation rates to ensure the rates we are currently using are correct and to ensure that our depreciation isn't overstated.

Further to this, we will apply a higher level of scrutiny to our larger outlays of maintenance type work which we expense during the year. From time to time we make improvements to assets through a maintenance program and these expenditures are considered to be operating in nature rather than capital. When these expenditures are a genuine capital expense they will be moved to the balance sheet rather than expensed through the operating statement. While this additional scrutiny (and any consequent change in expense classification) will have a positive impact on our net result, the impact will be minimal with regards to the Shire achieving the basic standard of this ratio.

Attached are Minute Extracts from the meetings held on 15th April 2020, which outline the processes undertaken by the Shire of Kulin to address the issues outlined in your letter with the key recommendations endorsed by each meeting.

Minute Extract - Audit and Risk Committee 15th April 2020.

Item 6.1 DLGSC Response Regarding 2018-19 Financial Report

A5/0420

Moved Cr Duckworth Seconded Cr Lucchesi that the Audit & Risk Committee recommend to Council that they accept the report of significant matters as presented in the Auditor's Report for the 2018/2019 Annual Financial Report and authorising the CEO to prepare a letter to the Minister in response to the findings.

Carried 9/0

Minute Extracts - Ordinary Council Meeting 15th April 2020

Item 6.2 Shire of Kulin Audit & Risk Committee Meeting – 1 April 2020



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02/0420

Moved Cr Smoker Seconded Cr Noble that the minutes of the Audit & Risk Committee Meeting held on 1 April 2020 be confirmed as a true and correct record.

Carried 9/0

Carried 9/0

Carried 9/0

Item 7.4 DLGSC Response Regarding 2018-19 Financial Report

09/0420

Moved Cr Duckworth Seconded Cr Robins that Council accept the recommendation of the Audit & Risk Committee in accepting the report of significant matters as presented in the Auditor's Report for the 2018/2019 Annual Financial Report and authorising the CEO to prepare a letter to the Minister in response to the findings.

Carried 9/0

This letter constitutes the written response from the Shire of Kulin to the Department confirming appropriate action. I trust this response sufficiently addresses the requirements of Section 7.12 (4) of The Local Government Act 1995.

Any further queries relating to this matter can be addressed directly to the Shire of Kulin CEO.

Yours sincerely

Garrick Yandle
Chief Executive Officer

Cc
Shire of Kulin President, Cr Barry West
Alan Carmichael via email Alan.Carmichael@dlgsc.wa.gov.au