

SHIRE OF KOJONUP

# Kojonup



## Audit & Risk Committee Agenda

5 November 2019

## TERMS OF REFERENCE

### AUDIT & RISK COMMITTEE

#### Function:

This Committee is responsible for assisting Council in recommending appropriate actions to Council with regards to audit, risk and governance management to ensure accountability to the community in its responsibilities.

#### Duties and Responsibilities:

- Receive and review the biannual reports from the Chief Executive Officer (CEO) regarding the appropriateness and effectiveness of the Shires risk management, internal controls and legislative compliance and make recommendations to Council;
- Recommend and review the Shires Risk Appetite Statement in order to set the Risk Tolerance of the Council;
- Monitor and receive reports concerning the development, implementation and on-going management of the Shires Risk Management Plan and the effectiveness of its Risk Management Framework;
- Provide advice and assistance to Council as to the carrying out of its functions in relation to audits and recommend;
  - a) a list of those matters to be audited; and
  - b) the scope of the audit to be undertaken;
- Meet with the auditor yearly and provide a report to Council on the matters discussed and the outcome of the discussions;
- Liaise with the (CEO) to ensure that the Shire does everything in its power to:
  - a) assist the auditor to conduct the audit and carry out his or her other duties under the *Local Government Act 1995*; and
  - b) ensure that audits are conducted successfully and expeditiously;
- Examine the reports of the auditor after receiving a report from the CEO on the matters and:
  - a) determine if any matters raised require action to be taken by the Shire; and
  - b) ensure that appropriate action is taken in respect of those matters;
  - c) Review the report prepared by the CEO in respect of any matters raised in the report of the auditor and present the report to Council for adoption prior to the end of the next financial year or six months after the last report prepared by the auditor is received, whichever is the latest;
- Review the scope of the Audit Plan and its effectiveness;
- Consider and recommend adoption of the Annual Financial Report to the Council;
- Address issues brought to the attention of the Committee, including responding to requests from Council for advice that are within the parameters of the Committee's terms of reference;
- Seek information or obtain expert advice through the CEO on matters of concern within the scope of the Committee's terms of reference following authorisation from the Council; and
- Review the annual Statutory Compliance Return and make a recommendation on its adoption to Council.

#### Membership

Four (4) Councillors; and

Two (2) Community Members.

**AGENDA FOR THE AUDIT AND RISK COMMITTEE MEETING**  
**HELD ON 5 NOVEMBER 2019**

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## AGENDA

### 1 DECLARATION OF OPENING

The Manager Corporate & Community Services declared the meeting open at 9:12am and alerted the meeting of the procedures for emergencies including evacuation, designated exits and muster points.

### 2 ATTENDANCE, APOLOGIES & LEAVE OF ABSENCE

#### MEMBERS

|                    |                  |
|--------------------|------------------|
| Cr Kevin Gale      | Member           |
| Cr Parminder Singh | Member           |
| Cr Cindy Wieringa  | Member           |
| Cr Felicity Webb   | Member           |
| James Hope         | Community Member |
| Roger House        | Community Member |

#### STAFF (OBSERVERS)

|                   |                                           |
|-------------------|-------------------------------------------|
| Anthony Middleton | Manager of Corporate & Community Services |
| Heather Marland   | Senior Finance Officer                    |
| Judy Stewart      | Senior Administration Officer             |

#### SENIOR MANAGEMENT TEAM VISITOR:

|                 |                                  |
|-----------------|----------------------------------|
| Michelle Dennis | Development Services Coordinator |
|-----------------|----------------------------------|

#### APOLOGIES

Nil

### 3 PUBLIC QUESTION TIME

Nil

### 4 SUMMARY OF RESPONSE TO PREVIOUS QUESTIONS TAKEN ON NOTICE

Nil.

### 5 ELECTION OF CHAIRPERSON

The Manager Corporate & Community Services called for nominations for the position of Chairperson for the Audit and Risk Committee for the next two (2) year period. If more than one nomination is received, an election will be held in accordance with the *Local Government Act 1995*.

Cr C Wieringa nominated Mr J Hope, Mr J Hope declined the nomination.

Cr Singh nominated Cr Gale, Cr Gale accepted the nomination

A time period was allowed for further nominations. There being no further nominations, Cr Gale was declared elected to the position of presiding member of the Audit Committee for a 2 year term.

Cr Gale assumed the chair and presided over the remainder of the meeting.



**6      CONFIRMATION OF MINUTES**

Audit & Risk Committee Meeting held 6 August 2019 ([Attachment 6.1](#))

**OFFICER RECOMMENDATION/COMMITTEE DECISION**

Moved Mr J Hope, seconded Mr R House that the minutes of the Audit & Risk Committee Meeting held on 6 August 2019 be confirmed as a true and accurate record.

Carried 6/0

**7      DECLARATIONS OF INTEREST**

Nil

**8      SENIOR MANAGEMENT TEAM DISCUSSION**

In accordance with the Financial Management Review adopted in February 2019, one senior manager will attend the Audit & Risk Committee on a rotational basis to discuss the following:

- Update on Manager's areas of responsibility and current projects/issues;
- Questions on Notice from the Audit Committee;
- Managements own recommendations for improvement in key areas;

Michelle Dennis, Development Services Coordinator attended this meeting. Questions on Notice can be submitted via email to [health@kojonup.wa.gov.au](mailto:health@kojonup.wa.gov.au).

**Meeting Notes**

The Development Services Coordinator addressed the committee as follows:

- There are currently 4 in the Regulatory Services team, 2 full time (Development Service Coordinator and Ranger/Building Maintenance Coordinator) and 2 part time (Planner 1 day a week and Admin support 2 days a week) who are tasked to enforce Acts that are State or Federally dictated.
- There are external bodies that the Shire is answerable to and are monitored by.
- An overview of the local government tendering process was given, including thresholds and legal requirements, after which general discussion on tendering was held.

## **9      AUDIT & RISK COMMITTEE TIMETABLE**

As a guide and subject to availability, each Audit & Risk Committee agenda will contain the following **(list to be expanded at the suggestion of members)**:

### **1st Quarter (January – March)**

- Committee Status Report
- Compliance Audit Return
- Summary of Risk Management
- Volunteer Management
- Leave Provision Adequacy

### **2nd Quarter (April – June)**

- Committee Status Report
- Summary of Risk Management
- Fees & Charges Review
- Business Continuity Plan Review
- Shire President's Vehicle Log Book

### **3<sup>rd</sup> Quarter (July – September)**

- Committee Status Report
- Interim Audit Report
- Summary of Risk Management
- Insurance Overview

### **4<sup>th</sup> Quarter (October – December)**

- Committee Status Report
- Audit Report & Management Letter
- Annual Financial Report
- Annual Report
- Financial Management Review (each 3 years – 2018, 2021...)
- Risk, Legal Compliance & Internal Controls review (each 3 years – 2018, 2021...)
- Summary of Risk Management

### **OFFICER COMMENT**

The above list will remain at the commencement of each Committee agenda to act as a timetable and enable members to add to the items to be considered.

## 10 REPORTS

### 10.1 STATUS REPORTS

#### 10.1.1 COMMITTEE STATUS REPORT

| Date             | Item Number & Title                                   | Issue                                                                                                                                                | Response                                                                                                                                                                   | Status             |
|------------------|-------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------|
| 15 May 2018      | 9.3 – Focus Audit<br>- Timely Payment<br>of Suppliers | The Shire should pay all invoices within 30 days of the receipt of the invoice or receipt of the goods and services.                                 | Training of all staff and authorising officers to be undertaken to have invoices signed and to Finance Officer in a timely manner for payment.<br>Action - Finance Officer | Partially Complete |
| 19 February 2019 | 10.3 Financial<br>Management<br>Review                | Financial Ratios <ul style="list-style-type: none"> <li>That the useful life prediction used to calculate depreciation rates be reviewed.</li> </ul> | Agenda item in this agenda.                                                                                                                                                |                    |

### 10.1.2 RISK MANAGEMENT SIX MONTHLY SUMMARY

(Attachments 10.1.2.1 and 10.1.2.2)

The Shire's Risk Management Framework (Framework) was adopted by the Council in May 2019, replacing its original Risk Management Plan (Plan). Fifteen Risk Profiles exist within the Framework and each Risk Profile contains a list of risks, potential causes, and key controls relevant to local government. From these Risk Profiles emanate any actions required to mitigate the identified risks and these, in turn, are assigned to an Officer for action. These actions flow through to a Risk Dashboard Report which is provided to the Audit and Risk Committee and Council for perusal (see attachment 10.1.2.1).

The 15 Risk Profile areas are:

- Asset Sustainability;
- Business Disruption;
- Compliance;
- Document Management;
- Employment Practices;
- Engagement;
- Environment;
- Errors, Omissions and Delays;
- External Theft and Fraud;
- Facilities and Venues;
- IT and Communications;
- Misconduct;
- Project – Change Management;
- Safety and Security; and
- Supplier – Contract.

These Risk Profiles were provided by Local Government Insurance Services (LGIS) and are local government generic in nature, ensuring that the Shire is identifying and mitigating risks common to local government. Regular review of the documentation, and transferal of information from the original Plan's Risk Register, has seen the content become more Shire of Kojonup specific, particularly in relation to those Shire activities that are not core local government business activities (i.e.; The Kodja Place and Springhaven Lodge). Other data is also captured such as controls assurance and risk rating trends that are established over time and represent a work in progress.

Areas of risk consequence are divided into nine categories (Health, Financial Impact, Service Interruption, Compliance, Reputational, Property, Environment, Project Time and Project Cost) and five rating levels (Insignificant through to Catastrophic) to form Measures of Consequence. These consequences are then combined with Measures of Likelihood that feed into a Risk Matrix where a risk rating of Low, Moderate, High or Extreme is established (see attachment 10.1.2.2). These risk ratings influence the priority given to actions assigned to Risk Profile items requiring attention.

Review and updating of the Risk Framework Actions List occurs on a regular basis with progress and urgency of items addressed at fortnightly administration staff meetings and monthly Senior Management Team meetings. This provides for all managers and administration staff to participate in discussion on risks, controls and actions.

### **10.1.3 RISK MANAGEMENT UPDATE**

#### **10.1.3.1 RISKWEST – EVENTS RISK MANAGEMENT WORKSHOP**

The Manager Corporate and Community Services and Senior Administration Officer attended an Events Risk Management Workshop in Floreat on 21 August 2019, arranged by Parks and Leisure Australia and conducted by Riskwest Management Consultants (Riskwest). Riskwest assists corporate, government and community service organisations with the development, implementation and validation of risk management and business continuity capabilities. The workshop provided an overarching understanding of risk and focussed on risk management for events including preparation of risk management plans for various event scenarios. Topics addressed in the scenarios included, amongst others: preparation for dealing with the occurrence of emergencies, traffic management prior to and during an event, crowd and hot weather issues, delineation of event space and potential hostile people/terrorism attack. An Event Risk Management Plan template prepared by Riskwest has since been obtained for use by the Shire of Kojonup.

The next regional LGIS Great Southern Risk Forum will be hosted by the City of Albany on 5 and 6 December 2019 with topics yet to be advised.

#### **10.1.3.2 KOJONUP SHOWGROUNDS – LGIS RISK ASSESSMENT**

This risk assessment is currently being prepared and will be included in a future agenda for the Committee.

**11 OFFICER REPORTS****11.1 DRAFT POLICY – FRAUD, CORRUPTION AND MISCONDUCT PREVENTION**

|                      |                                                                                                                                             |
|----------------------|---------------------------------------------------------------------------------------------------------------------------------------------|
| <b>AUTHOR</b>        | Judy Stewart – Senior Administration Officer                                                                                                |
| <b>DATE</b>          | Wednesday, 28 October 2019                                                                                                                  |
| <b>FILE NO</b>       | CM.POL.2                                                                                                                                    |
| <b>ATTACHMENT(S)</b> | <p>11.1.1 Draft Fraud, Corruption and Misconduct Prevention Policy</p> <p>11.1.2 Draft Fraud, Corruption and Misconduct Prevention Plan</p> |

| STRATEGIC/CORPORATE IMPLICATIONS      |                                                                                                                           |                                                                                                     |
|---------------------------------------|---------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------|
| “Smart Possibilities – Kojonup 2027+” |                                                                                                                           | “Smart Implementation – Kojonup 2018-2022”                                                          |
| <b>Key Pillar</b>                     | <b>Community Outcomes</b>                                                                                                 | <b>Corporate Actions</b>                                                                            |
| KP3 - Performance                     | 3.1 – Be a continually engaged and strategic community which leads and organises throughout the entire stakeholder group. | 3.1.5 – Implement strategies to improve Councillors role as community leaders and asset custodians. |

**DECLARATION OF INTEREST**

Nil; however, it is noted that all Elected Members, Committee Members and Council Employees are bound by Council Policy 3.1 – Code of Conduct.

**SUMMARY**

The purpose of this report is to consider the addition of a Fraud, Corruption and Misconduct Prevention Policy to its suite of policies that will act in synergy with Council’s Code of Conduct.

**BACKGROUND**

Council’s Policy 3.1 – Code of Conduct represents a framework for behaviour expected of its Elected Members, Committee Members and Employees during the course of conducting local government activities; it is a statutory requirement for a Council to have a Code of Conduct.

Many local governments also have a policy that deals with fraud, corruption, misconduct and related issues. Whilst Codes of Conduct focus heavily on acceptable behaviour standards, a policy addressing fraud, corruption, misconduct etc. provides guidance on the implementation of strategies to prevent, detect and respond to such matters.

**COMMENT**

With the coming to light of instances of fraud, corruption and misconduct within the local government sector in recent years, the need for policies and strategies that assist with the mitigation of these risks has been well demonstrated. It is generally recognised that commitment is required from all levels of the organisation to work towards prevention of such activity.



A Fraud, Corruption and Misconduct Prevention Policy communicates a zero tolerance approach to inappropriate behaviour within the performance of a local government's functions, its interactions with others, and its commitment to dealing with all such behaviour including allegations and suspected instances of same. As with a Code of Conduct, it applies to Elected Members, Committee Members, Employees and all other workers (whether by way of appointment, secondment, contract, agency staff, temporary arrangement or volunteering) and external parties involved in providing goods and services to a local government such as contractors, consultants and other outsourced service providers.

The objective of a Fraud, Corruption and Misconduct Prevention Policy is to:

- Define fraud, corruption and misconduct;
- Provide assurance that allegations and their investigation will be handled confidentially; and
- Provide direction on how allegations and occurrences of fraud, corruption or misconduct are to be managed.

It is envisaged that the outcomes of having a Fraud, Corruption and Misconduct Policy will include:

- A clear understanding of fraud, corruption and misconduct and mitigation of their likelihood;
- Reinforcement of the Council's Code of Conduct and a commitment to maintaining high ethical standards and integrity;
- Clearly outlining the responsibilities of all parties in relation to prevention, detection and responses taken towards allegations or incidents of fraud, misconduct, corruption or related activities; and
- The re-iteration throughout all levels of the organisation that such conduct is inappropriate and will not be tolerated.

## CONSULTATION

Chief Executive Officer

References: Northern Midlands Council – Fraud & Corruption Control Policy

City of Wanneroo – Fraud, Corruption, Bribery and Misconduct Policy

City of Joondalup – Fraud, Corruption and Misconduct Control Policy

## STATUTORY REQUIREMENTS

The Council may adopt, amend or waive policies under s. 2.7 (2) of the *Local Government Act 1995*:

### 2.7. Role of council

#### (1) The council —

- (a) governs the local government's affairs; and
- (b) is responsible for the performance of the local government's functions.

#### (2) Without limiting subsection (1), the council is to —

- (a) oversee the allocation of the local government's finances and resources; and
- (b) determine the local government's policies.

**POLICY IMPLICATIONS**

Whilst policies have no legal status, they provide guidance and direction for staff and assist them to act with consistency on various matters. A Fraud, Corruption and Misconduct Prevention Policy such as the one referred to in (and attached to) this report, demonstrates zero tolerance to these and related, inappropriate activities.

**FINANCIAL IMPLICATIONS**

Nil

**RISK MANAGEMENT IMPLICATIONS**

| RISK MANAGEMENT FRAMEWORK           |                                                                                                                                                                                                                                                                                                                                                                                  |                                                                                                                                                                                                                                                                               |                                                                                    |
|-------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------|
| Risk Profile                        | Risks<br>Description/Cause                                                                                                                                                                                                                                                                                                                                                       | Key Controls                                                                                                                                                                                                                                                                  | Current Action                                                                     |
| <i>5 – Employment Practices</i>     | <i>Failure to effectively manage and lead human resources; Ineffective performance management programmes or procedures</i>                                                                                                                                                                                                                                                       | <i>Human Resource Management (Policies and Procedures); Formal disciplinary process</i>                                                                                                                                                                                       |                                                                                    |
| <i>9 – External Theft and Fraud</i> | <i>Loss of funds, assets, data or unauthorised access (whether attempted or successful) by external parties, through any means (including electronic), for the purposes of;<br/>-Fraud: benefit or gain by deceit<br/>-Malicious Damage: hacking, deleting, breaking or reducing the integrity or performance of systems<br/>-Theft: stealing of data, assets or information</i> | <i>Building security access controls; CCTV for key buildings; Record of assets (minor and attractive items/fixed assets); Cash handling processes; Depot security access controls; IT firewall systems; Processes for IT passwords; Supplier details verification process</i> | <i>Depot – reinforcement of doors and windows; Updating of fixed assets record</i> |
| <i>12 – Misconduct</i>              | <i>Intentional activities in excess</i>                                                                                                                                                                                                                                                                                                                                          | <i>Induction process (Code of Conduct);</i>                                                                                                                                                                                                                                   |                                                                                    |



|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |                                                                                                                                                                                                                                                                                                                                                                                                                                                               |  |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|
|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | of authority granted to an employee, which circumvent endorsed policies, procedures or delegated authority including: - Relevant authorisations not obtained; -Distributing confidential information; -Accessing systems and/or applications without correct authority to do so; -Misrepresenting data in reports; -Theft by an employee; -Inappropriate use of plant, equipment or machinery; -Inappropriate use of social media; -Inappropriate behaviour at work; and -Purposeful sabotage. | Formal disciplinary process; IT security access framework; Segregation of duties; Budget monitoring; Cash handling procedures; Credit card management (policies); Delegation Register; Elected Member training; External audits; Fuel card management; Minor and attractive assets stocktake; Police clearances; Social media policy; Stock control and reconciliation; Strong management culture (low tolerance of misconduct); Working with Children Checks |  |
| IMPLICATIONS                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |                                                                                                                                                                                                                                                                                                                                                                                                                                                               |  |
| <p><i>In addition to existing Risk Management practices that identify risk and put preventative measures in place (as above) to lessen the likelihood of fraud, corruption and misconduct, a policy provides formal guidance and instruction on implementing strategies that prevent, detect and respond to fraud, misconduct and related inappropriate activity. Without such risk management controls being in place, the Council and Shire would be unnecessarily exposed, at varying levels, across several risk consequence areas; particularly, financial impact, service disruption, compliance and reputational risk.</i></p> <p><i>Having such a policy not only demonstrates a zero tolerance of fraudulent and other inappropriate activities, it also directs the strategies to be implemented to minimise the likelihood of those activities' occurrence.</i></p> |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |                                                                                                                                                                                                                                                                                                                                                                                                                                                               |  |

**ASSET MANAGEMENT IMPLICATIONS**

Nil; however, a Fraud, Corruption and Misconduct Prevention Policy works to protect a local government's assets by providing direction on the mitigating of fraudulent activity such as the un-authorised use of, or substantial mismanagement of, public resources that in turn impacts on a local government's ability to manage its assets.

**SOUTHERN LINK VROC (VOLUNTARY REGIONAL ORGANISATION OF COUNCILS) IMPLICATIONS**

Nil

**VOTING REQUIREMENTS**

Simple Majority

**OFFICER RECOMMENDATION/COMMITTEE DECISION**

Moved Mr J Hope, seconded Mr R House that it be recommended to the Council that the Draft Policy 3.24 – Fraud, Corruption and Misconduct Prevention, as attached, be adopted.

CARRIED 6/0

## 11.2 OPERATING SURPLUS RATIO – PROGRESS REPORT

|                      |                                                            |
|----------------------|------------------------------------------------------------|
| <b>AUTHOR</b>        | Anthony Middleton – Manager Corporate & Community Services |
| <b>DATE</b>          | Tuesday, 29 October 2019                                   |
| <b>FILE NO</b>       | FM.AUD.1                                                   |
| <b>ATTACHMENT(S)</b> | Nil.                                                       |

| STRATEGIC/CORPORATE IMPLICATIONS      |                                                                   |                                                                                                                                                                                                          |
|---------------------------------------|-------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| “Smart Possibilities – Kojonup 2027+” |                                                                   | “Smart Implementation – Kojonup 2018-2022”                                                                                                                                                               |
| <b>Key Pillar</b>                     | <b>Community Outcomes</b>                                         | <b>Corporate Actions</b>                                                                                                                                                                                 |
| KP – 3 Performance                    | 3.4 – Be organised and transparent with our financial management. | 3.4.1 - Increase regularity of readable financial reporting to the community.<br>3.4.2 – Act with sound long-term and transparent financial management and deliver residents considered value for money. |

## DECLARATION OF INTEREST

Nil.

## SUMMARY

To consider an ongoing review of the Operating Surplus Ratio in accordance with the Committee’s decision at its 6 August 2019 meeting.

## BACKGROUND

The Operating Surplus Ratio is a measure of the extent to which own source revenues raised covers operational expenses. The higher the ratio, the greater the ability to operate effectively on own source revenue.

The Operating Surplus Ratio is calculated as follows:

$$\frac{\text{Operating Revenue minus Operating Expenses}}{\text{Own Source Operating Revenue}}$$

Contained within the 2017/2018 Audit Report was a matter identified as significant by the Auditor. This matter raised by the Auditor was as follows:

‘Significant adverse trend in the financial position of the Shire: Operating Surplus Ratio below the Department standard for the last three years.’

The historical results for the Shire of Kojonup for the Operating Surplus ratio are as follows:

| Date                    | 2012 | 2013   | 2014   | 2015 | 2016   | 2017   | 2018   | 2019<br>(Draft) |
|-------------------------|------|--------|--------|------|--------|--------|--------|-----------------|
| Operating Surplus Ratio | 0.11 | (0.11) | (0.15) | 0.01 | (0.28) | (0.41) | (0.30) | (0.40)          |

#### Ratio Departmental Standards:

Targets set by the Department of Local Government guidelines for this ratio are as follows:

|                               |                   |
|-------------------------------|-------------------|
| 0.1 (1%) or less              | Concern           |
| Between 0.1 & 0.15 (1% & 15%) | Basic achievement |
| 0.15 (15%) or above           | Advanced          |

Following a recommendation from this Committee (at its meeting held 6 August 2019), the Council resolved on 20 August 2019 as follows:

**That:**

1. The information contained within this report relating to the Operating Surplus Ratio be received;
2. It is recognised that the Operating Surplus Ratio may decrease further in 2018/2019 and 2019/2020 before improvements are experienced;
3. The Operating Surplus Ratio be reviewed by the Audit & Risk Committee at each meeting until such time as the 'Basic Achievement' standard is met ; and
4. The Manager Corporate & Community Services be requested to forward a copy of the Committee and the Council agenda items to the Minister for Local Government and placed on the Shire website in accordance with Section 7.12A (Duties of local government with respect to audits) of the Local Government Act 1995.'

This agenda item addresses point 3 in the decision above.

#### COMMENT

There are many factors to be considered when addressing this issue as raised by the Council's Auditors. For example, "*below the Department standard*" is an arbitrary measure not a legislative requirement. Balancing the provision of community services versus achieving an operating surplus is another.

#### Issues with the Ratio Calculation:

The method of calculating this ratio poses several philosophical problems in the application of the accounting standards.

The main issue is the exclusion of 'Non-Operating Grants, Subsidies and Contributions' such as road grants and one-off grants for building assets such as housing. Roads grants, such as 'Roads to Recovery', 'Direct Road' and 'Regional Road Group' are long term local government funding streams that have existing, in some cases, for decades. As such, it is acceptable to expect these funding sources to exist into the future. Secondly, these grants fund new assets or asset renewal and upgrade which all flow through to 'Operating Expenses' via increased depreciation and maintenance costs, thus negatively affecting both sides of the ratio calculation.

Road grants and specific grants for built assets (such as the Great Southern Housing Initiative) were received by local authorities fifty years ago, are still being received today and are very likely to be available 50 years into the future. The exclusion of these 'Non-Operating Grants, Subsidies and Contributions' can result in a surplus being turned into a deficit. As such, it seems unusual they be excluded from the ratio calculation.

#### What has Caused the Ratio to Decline?

During the eight year time frame reported on above, expenses are constantly increasing, whilst our "own source revenue", which is the denominator in this ratio calculation, is relatively stagnant. Some simple examples of why the ratio isn't improving include:

##### **Property Rate Increases:**

The property rate increase in the 2019/2020 budget is 3.0%, which represents an additional \$117,417 of revenue. This proposed rate raise does not sufficiently fund the additional cost of doing business and therefore management have worked hard to find additional operating efficiencies elsewhere to balance the budget. For example, in the 2019/2020 budget:

- Springhaven Lodge operating loss has increased by \$131,885;
- Road Maintenance expenses have increased by \$178,950;
- The Council donation to the new Medical Centre totals \$140,000; and
- Audit costs have increased \$13,000 now that Audits are completed by the State Government.

The above four examples alone represent a rate increase of 11.85% yet rates increased by only 3.0%.

In the time period 30 June 2013 to 30 June 2018, total rates revenue increased by 18.4%. Rates are the primary 'own income source' available to the Council and represent the single biggest opportunity to increase revenue and therefore the operating surplus ratio.

##### **Insurance Expenses:**

In the time period 30 June 2013 to 30 June 2018, the total cost of insurance has increased from \$223,525 to \$314,219, an increase of 40.6%.

Insurance levels have been presented to the Committee for the previous three (3) financial years and no savings have been identified. A risk versus cost approach needs to be taken with caution when reviewing insurances. The implementation of the Shire's Building Assessment Framework rationalisation process will assist with lowering insurance costs (less assets owned equals less insurance paid).

##### **Wages & Salaries:**

In the time period 30 June 2013 to 30 June 2018, the total cost of wages and salaries has increased from \$3.13m to \$4.6m, an increase of 46.8%. This is primarily due to the creation of new positions and the annual increases prescribed by the Shire of Kojonup All of Staff Enterprise Bargaining Agreement (EBA).

A new EBA is currently being negotiated between the CEO and staff which presents the opportunity to slow the rate of wage increases currently being experienced, which will in turn assist the ratio to improve.

**The Kodja Place:**

In the time period 30 June 2013 to 30 June 2018, the total loss incurred by The Kodja Place has increased from \$242,000 to \$650,000, an increase of 168.3%. This is due to the change in management and operational structure.

The Kodja Place represents the simplest way to instantly improve this ratio, either through increased revenue or a reduction in opening hours (and therefore operating expenses).

**Road Maintenance Expenditure:**

In the time period 30 June 2013 to 30 June 2018, total road maintenance expenditure increased by 10.1%.

Road Maintenance expenditure in 2018/2019 was up by \$255,000 (from budget estimates) yet no corresponding revenue was received (including this financial year into the calculations would bring the percentage increase from 30 June 2013 up to 17.8%). Whilst efficiencies are always encouraged, road maintenance is the basic core function of any rural local government and it is not recommended to reduce expenditure in this area purely for the improvement of a ratio.

**Springhaven Lodge:**

Springhaven Lodge's 2018/2019 budgeted operating loss of \$96,582 was exceeded by \$232,087 (total operating loss of \$328,669).

The future operations of Springhaven Lodge is definitely an area that can be further investigated to improve this ratio. The presence of a 22 bed aged care facility in Kojonup is exceptionally important to the community, however, the question of whether or not the Shire needs to be the owner and operator of such a facility should be looked into further.

**Swimming Pool:**

Swimming Pool entry fees cut by more than half in 2015 to improve patronage.

It should be emphasised that the Author is not criticising the examples and initiatives shown above, in fact they are all valuable to the community. Unfortunately though, each example has a negative effect on the Operating Surplus Ratio and is therefore identified. This is why a balance between 'the good of the community' and an emphasis on financial ratios is so important.

Action that can be taken to rectify the Ratio:

The difficulty in addressing the Auditors comments from the 2017/2018 Audit Report is that the Local Government Act requires a report to be prepared “*stating what action the local government has taken or intends to take*”. This is not going to be easy as, if anything, the situation has got worse, not better:

- The 2018/2019 financial year incurred a substantial operating loss due to Springhaven’s finances and increased road maintenance expenditure (Note – No actual loss was incurred due to the prepayment of 2019/2020 Financial Assistance Grant funds); and
- The budget for 2019/2020 will see the ratio worsen yet again with a considerable operating deficit as the budget has a heavy reliance on non-operating (capital) grants and reserve account transfers to achieve the coming year’s goals.

Suggestions have been made above under the headings of rates, insurance, wages and salaries, The Kodja Place and Springhaven Lodge to assist with future decisions that would improve the ratio. It should always be remembered that it is very easy for the Author to provide ‘mathematical’ solutions to improve the ratio, simply by “cutting this service” or “raising that fee”, however, the decisions required to be made will have more far reaching impacts than merely improving financial ratios. Such ‘blunt’ examples or suggestions on how to improve the ratio may not be in the best interests of the community.

Summary

It is very relevant that the importance of these ratios is put into perspective and be cognisant that over seventy (70) local governments in WA are in the same situation with this ratio. Ratios that cover all local governments in WA, regardless of size or geographic location, are a very rudimentary way of evaluating performance and it is vital to see these ratios as only one part of the jigsaw puzzle. While they are important, it is the trend of each ratio that gives the biggest indicator to performance, rather than merely the gross ratio score itself.

The above commentary surrounding the Operating Surplus ratio seeks to provide the Audit & Risk Committee and the Council with the information necessary to inform future decision making and to assess the financial performance of the Shire now and into the future. It is not the Author’s intention to magically solve this ratio overnight, as the above information shows that it will likely get worse before it gets better, however, awareness of all of the issues allows financial information and systems to be continually improved.

The Committee is encouraged to add its own recommendations or requests to the Author’s comments as part of any motions passed for this agenda item.

**CONSULTATION**

Audit & Risk Committee Meeting – 6 August 2019.

Council – 20 August 2019

Chief Executive Officer

Senior Finance Officer



## STATUTORY REQUIREMENTS

Section 7.12A. (Duties of local government with respect to audits) of the *Local Government act 1995* states:

- (1) A local government is to do everything in its power to —
  - (a) assist the auditor of the local government to conduct an audit and carry out the auditor's other duties under this Act in respect of the local government; and
  - (b) ensure that audits are conducted successfully and expeditiously.
- (2) Without limiting the generality of subsection (1), a local government is to meet with the auditor of the local government at least once in every year.
- (3) A local government must —
  - (aa) examine an audit report received by the local government; and
  - (a) determine if any matters raised by the audit report, require action to be taken by the local government; and
  - (b) ensure that appropriate action is taken in respect of those matters.
- (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.
- (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.

## POLICY IMPLICATIONS

Nil

## FINANCIAL IMPLICATIONS

This item reports on the current financial position of the Shire. The recommendation does not in itself have a financial implication.

## RISK MANAGEMENT IMPLICATIONS

| RISK MANAGEMENT FRAMEWORK <i>follow hyperlinks above (2<sup>nd</sup> hyperlink for Risk Profiles)</i> |                                                                                                                                                                                   |                                                                                                                                                                                                                                   |                |
|-------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|
| Risk Profile                                                                                          | Risk Description/Cause                                                                                                                                                            | Key Control                                                                                                                                                                                                                       | Current Action |
| 3 - Compliance                                                                                        | <ul style="list-style-type: none"> <li>• <i>Ineffective policies &amp; processes</i></li> <li>• <i>Impulsive decision making</i></li> <li>• <i>Councillor turnover</i></li> </ul> | <ul style="list-style-type: none"> <li>• <i>Audit and Risk Committee</i></li> <li>• <i>External Audits (compliance)</i></li> <li>• <i>Financial management reviews</i></li> <li>• <i>Industry Standards maintained</i></li> </ul> | <i>Nil.</i>    |

|                                                                                                                                                                                                                                                                                                                                                                                             |  |                            |  |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|----------------------------|--|
|                                                                                                                                                                                                                                                                                                                                                                                             |  | (LIWA/Royal<br>Life, AIBS) |  |
| IMPLICATIONS                                                                                                                                                                                                                                                                                                                                                                                |  |                            |  |
| <p><i>Indicators:</i><br/> <i>Audit notifications</i><br/> <i>Increased scrutiny from regulators or agencies</i><br/> <i>Letters from the Department of Local Government</i></p> <p><i>Officer Comment:</i><br/> <i>An independent audit process is a key risk management control mechanism and greatly assists in the identification of system, process or financial improvements.</i></p> |  |                            |  |

#### ASSET MANAGEMENT IMPLICATIONS

Nil.

#### SOUTHERN LINK VROC (VOLUNTARY REGIONAL ORGANISATION OF COUNCILS) IMPLICATIONS

Nil.

#### VOTING REQUIREMENTS

Simple Majority

#### OFFICER'S RECOMMENDATION

That the information contained within this progress report relating to the Operating Surplus Ratio be received.

#### COMMITTEE DECISION

Moved Mr R House, seconded Cr K Gale that the Council as a whole start thinking of ways to address the Operational Surplus Ratio with long and short term plans, to bring the ratios back into balance.

CARRIED 6/0

12 OTHER ITEMS FOR DISCUSSION OR FURTHER RESEARCH AS RAISED BY MEMBERS

12.1 USEFUL LIFE OF ASSETS REVIEW

The independent four (4) yearly Financial Management Review undertaken in December 2018 by McLeod Corporation Pty Ltd provided six (6) recommendations for improvement. The only outstanding recommendation pertains to financial ratios and is as follows:

**“The Shire has improved its financial operating ratios – which are reported on the My Council website.**

**Only own source revenue coverage ratio does not meet with expectations consistent with other regional Councils.**

**We recommend that the useful life prediction used to calculate depreciation rates be reviewed.**

**The operating financial ratios are analysed in detail following at section 6, page 17.”**

Simply put, to improve our ratio it has been suggested that depreciation amounts be amended to reduce this expense and therefore improve the ratios. It is considered by the Manager Corporate & Community Services (the Author) that this course of action is side stepping the whole process and would question the reason for calculating and reporting the ratios at all if the answer to a poor ratio is just to “change the figures”.

However, let’s have a quick ‘back of the envelope’ look at our depreciation rates to see if this idea has merit.

In the 2017/2018 Annual Financial Report, the Shire has approximately \$160m of ‘fixed’ assets. The majority of this (\$130m) is Infrastructure and the majority of Infrastructure is roads. Some components of roads (e.g. formation) don’t depreciate at all, whereas other components (e.g. seal) depreciates over 20 years. The average for all components is 50 years.

*First calculation:*

$$\frac{\$130m}{50 \text{ years}} = \$2.6m \text{ per year}$$

*Actual Infrastructure depreciation in 2017/2018* = \$2.05m

*Difference* = (\$550,000)

Of the other assets (property, plant & equipment), the Shire has approximately \$30m. Depreciation rates for these assets are as follows:

|                       |                 |
|-----------------------|-----------------|
| Land                  | not depreciated |
| Buildings             | 30 to 50 years  |
| Furniture & Equipment | 4 to 10 years   |
| Plant & Equipment     | 5 to 15 years   |

Applying current asset values to the middle of these ranges results in the following annual depreciation figures:

Second calculation:

|                       |              |   |             |
|-----------------------|--------------|---|-------------|
| Land                  | \$2.2m x 0%  | = | \$0         |
| Buildings             | \$25m x 2.5% | = | \$625,000   |
| Furniture & Equipment | \$0.4m x 15% | = | \$60,000    |
| Plant & Equipment     | \$3.9m x 10% | = | \$390,000   |
| TOTAL                 |              | = | \$1,075,000 |

Actual Property, Plant & Equipment depreciation in 2017/2018 = \$913,000  
 Difference = (\$162,000)

To summarise, a quick and rough approximate calculation shows annual depreciation should be around \$3.67m, whereas actual depreciation figures are \$2.96m. Without going into greater detail, decreasing depreciation figures does not seem like a wise idea. If anything, useful lives could be reviewed and depreciation increased.

This information is provided for the Committee to discuss, in conjunction with the recommendation from the Financial Management Review and suggest an appropriate course of action.

#### OFFICER RECOMMENDATION/COMMITTEE DECISION

Moved Cr K Gale, seconded Cr F Webb that it be recommended to the Council that the review of the useful life prediction used to calculate depreciation rates as identified in the December 2018 Financial Management Review not be required.

CARRIED 6/0

#### 13 NEXT MEETING

The next ordinary meeting is scheduled for Tuesday, 4 February 2020 at 9:00am. However it is anticipated that a meeting will be held in December 2019 to discuss the 2018/2019 Financial Audit Report.

#### 14 CLOSURE

There being no further business to discuss, the Chairman Cr K Gale thanked members for their attendance and declared the meeting closed at 11:20am.

#### 15 ATTACHMENTS (SEPARATE)

- 6.1 Audit & Risk Committee Minutes 6 August 2019
- 10.1.2.1 Risk Dashboard Report
- 10.1.2.2 Measures of Consequence and Likelihood, Acceptance Criteria, Control Ratings and Risk Matrix
- 11.1.1 Draft Fraud, Corruption and Misconduct Prevention Policy
- 11.1.2 Draft Fraud, Corruption and Misconduct Prevention Plan



Presiding Member

17 March 2020  
 Date